

III

The Internal Revenue Service has not yet rendered a decision on petitioners' claim for refund, but more than six months have now passed from the date of filing the claim for refund, and under the provisions of 26 USCA, § 7422, 26 USCA, § 6532(a), and 28 USCA, § 1346, petitioners are entitled to file suit in this Honorable Court for recovery of the tax which has been erroneously assessed, since six months have passed from date of filing without action taken.

IV

In the course of his business as an employee of Kelly-Generes Construction Co., Inc., and in order to protect his employment, petitioner Allen H. Generes signed a continuing indemnity agreement with Maryland Casualty Company, agreeing to hold them harmless on any losses they might suffer as the result of the said company's bonding construction contracts of Kelly-Generes Construction Co., Inc.

V

The herein-above-referred to execution of the indemnity bond was directly and proximately related to Allen H. Generes' business as an officer of Kelly-Generes Construction Co., Inc., was essential to the operation of the company's business, and was essential to protect and maintain his employment.

VI

In 1962, as a result of his obligation to indemnify Maryland Casualty Company under the said indemnity agreement, petitioner Allen H. Generes paid Maryland Casualty Company the sum of \$162,104.57 in connection with losses sustained by Maryland Casualty Company under bonds written for Kelly-Generes Construction Co., Inc.

VII

Petitioners claimed the payment as a business bad-debt deduction, which resulted in a net operating loss in 1962,

which under the provisions of Section 172 of the Internal Revenue Code resulted in a net operating loss in 1962 which was carried back for three years prior.

VIII

Petitioners filed a tentative carry-back claim, and the Internal Revenue Service automatically paid petitioners' claim upon filing by them of the said claim, however, upon examination, the Internal Revenue Service disagreed with petitioners' interpretation of the circumstances, and disallowed the net operating loss carry-back.

IX

The disallowance of the net operating loss carry-back resulted in the four assessments as hereinabove set forth in Article II of this petition.

X

Petitioners allege that they are entitled to a net operating loss in 1962 which can be carried back for three years prior under Internal Revenue Code Section 172, on the ground that the loss is either a loss incurred in a trade or business under Internal Revenue Code Section 165(c)(1), or it is a business bad debt under Internal Revenue Code Section 166.

XI

Alternatively, petitioners allege that the loss is allowable under Internal Revenue Code Section 165(c)(2) as a loss incurred in any transaction entered into for profit.

XII

Petitioners allege that at all times relevant herein, they were husband and wife, living in the State of Louisiana, and that the community property laws of the State of Louisiana apply to them with regard to income and losses at all times relevant herein.

XIII

Petitioners are entitled to a refund for the moneys paid on June 1, 1965, in accordance with the four assessments

made by the United States of America on May 20, 1965, in the aggregate amount of \$43,851.46, plus statutory interest thereon to June 1, 1965, until paid, and for all costs of these proceedings.

XIV

Petitioners demand trial by jury in this action.

WHEREFORE, petitioners pray that a certified copy of this petition be served on the United States of America, through the United States Attorney in New Orleans, Louisiana, and that a copy thereof be mailed to the Attorney General of the United States, and that a copy thereof be mailed by certified mail to the District Director, Internal Revenue Service, New Orleans, Louisiana, and that, after all due delays and legal proceedings had, there be judgment herein in favor of petitioners, Edna Generes, wife of and Allen H. Generes, and against the United States of America, for refund for the moneys paid in accordance with the four assessments dated May 20, 1965, in the aggregate amount of \$43,851.46, plus statutory interest thereon paid by taxpayers on June 1, 1965, plus statutory interest thereon from June 1, 1965, until paid, and for all costs of these proceedings; petitioners further pray for trial by jury in this action.

(Signed) **Max Nathan, Jr.**
MAX NATHAN, JR.

of

**SESSIONS, FISHMAN, ROSENSON
& SNELLINGS**
1333 National Bank of
Commerce Building
New Orleans, La. 70112
Attorneys for Petitioners

ANSWER
(Number and Title Omitted)

Filed: February 18, 1966

The defendant, the United States of America, by and through its attorney, Louis C. LaCour, United States Attorney for the Eastern District of Louisiana, for its answer to the complaint herein alleges as follows:

I

Admits the allegations contained in paragraph I.

II

Denies the allegations contained in paragraph II, except admits the following:

- (a) The amounts here in controversy were assessed on May 28, 1965.
- (b) Payment of such assessments was received by the District Director of Internal Revenue, New Orleans, Louisiana, on June 2, 1965.
- (c) On June 8, 1965, plaintiffs filed claims for refund of the amounts here in controversy.

III

Admits the allegations contained in paragraph III, except denies that any taxes or interest were erroneously assessed.

IV

Denies present knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph IV.

V

Denies the allegations contained in paragraph V.

VI

Denies present knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph VI.

VII

Denies the allegations contained in paragraph VII, except admits that plaintiffs claimed a business bad-debt deduction on their 1962 federal income tax return and, as a result thereof, claimed net operating loss carry-backs.

VIII

Admits the allegations contained in paragraph VIII.

IX

Denies the allegations contained in paragraph IX, except admits that the disallowance of the net operating loss carry-back resulted in deficiency tax and assessed interest assessments against the plaintiffs.

X

Denies the allegations contained in paragraph X.

XI

Denies the allegations contained in paragraph XI.

XII

Denies present knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph XII.

XIII

Denies the allegations contained in paragraph XIII.

XIV

Neither admits nor denies the allegations contained in paragraph XIV for the reason that such statement does not require an answer.

WHEREFORE, the defendant prays that this complaint be dismissed with prejudice, that all costs be assessed against the plaintiffs and that defendants have such other and further relief to which it may be justly entitled.

Louis C. LaCour
United States Attorney

(Signed) J. GEMEINHARDT
*Assistant United
 States Attorney*

PRE-TRIAL ORDER

Filed: June 29, 1967

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA
NEW ORLEANS DIVISION

EDNA GENERES, WIFE OF AND
ALLEN H. GENERES

versus

No. 16156
Section "C"

UNITED STATES OF AMERICA

1. A pre-trial conference was held in this matter on the 28 day of June, 1967, at 4:30 P.M.

2. The following counsel appeared:

a. For the Plaintiff:

Name

MAX NATHAN, JR.

Address

1333 National Bank of
Commerce Building
New Orleans, Louisiana

Telephone

522-9512

b. For the Defendant:

Name

PETER WINSTEAD

Address

418 United States Courthouse,
Fort Worth, Texas

Telephone

A/C 817

334-3141

c. Others:

Party: Lawyer's Name

NONE

Address

Telephone

3. The following claims, counter-claims, third-party
claims, cross-claims, etc., have been filed:

NONE

4. The basis for jurisdiction is 28 USC 1346. There is the following jurisdictional question:

NONE

5. There are pending motions as follows:

NONE

6. The following is a *concise summary* of the ultimate facts as claimed by:

a. The Plaintiff:

In the course of his business as an employee of Kelly-Generes Construction Co., Inc., Allen H. Generes signed a continuing indemnity agreement with Maryland Casualty Company, holding them harmless on any losses they might suffer as the result of the company's bonding construction contracts of Kelly-Generes. This indemnity bond was directly and proximately related to Mr. Generes' business as an officer of Kelly-Generes Construction Co., Inc., and was essential to the operation of the company's business. Without such indemnity, the company could not carry on its business or obtain new business.

In 1962, taxpayer paid Maryland Casualty Company \$162,104.57 in connection with losses sustained by Maryland Casualty Company under the bond written for Kelly-Generes Construction Co. Inc. Taxpayers claimed the payment as a business bad debt deduction, which resulted in a net operating loss in 1962 which was carried back for three years prior under Sec. 172. The Revenue Service automatically paid the claim upon filing by taxpayer of a tentative carry-back claim. Upon examination, however, the Internal Revenue Service disagreed with taxpayer's interpretation of the circumstances, and disallowed the net operating loss carry-back. The loss is one allowable under Internal Revenue Code Sections 165, 166 and 172, either as a loss incurred in connection with taxpayer's trade or business, or as a business bad debt, or alternatively, as a transaction entered into for profit.

b. The Defendant:

The expenditure in 1962 by the taxpayer Allen

H. Generes in the amount of \$162,104.57 pursuant to his obligation under an indemnity agreement with Maryland Casualty Company constituted a non-business expenditure (either as a non-business bad debt within the meaning of Section 166(d) of the IRC of 1954 or as a loss on a transaction entered into for profit within the meaning of Section 165(c)(2) of the 1954 Code), hence is not available for a net operating loss carryback to the year 1959, 1960 and 1961, thus the taxpayers are not entitled to the refunds of taxes and interest claimed. More specifically, the expenditure made by Mr. Generes, the taxpayer, was not proximately related to any trade or business of the taxpayer or created or acquired in connection with any business. The payment was not made to protect the salary or employee status of the taxpayer. The taxpayer's payment was made as a result of his status as a mere investor in Kelly-Generes Construction Co., Inc.

c. Other Parties:

NONE

7. The facts established by the pleadings or by stipulation or admission of counsel are as follows:

1. At all times material herein, plaintiffs were residents of the City of New Orleans, State of Louisiana.
2. This action arises under the Internal Revenue laws of the United States of America, and jurisdiction and venue herein are proper.

3. During all years here involved plaintiffs were husband and wife and filed joint income tax returns with the District Director of Internal Revenue at New Orleans, Louisiana, for the years 1959, 1961 and 1962. The plaintiffs filed separate income tax returns for the year 1960. Mrs. Generes is joined as a plaintiff in this lawsuit by reason of the joint income tax returns and her separate return for 1960.

4. In 1962 plaintiffs claimed a net operating loss under IRC 172 and carried it back for the three prior years of 1959, 1960 and 1961.

5. On audit of the plaintiffs' carry-back claim, the Internal Revenue Service made adjustments as to the

amount of the net operating loss as a carryback to 1959, 1960 and 1961, and accordingly assessed the taxpayers for the following years and amounts, and such amounts were paid under protest as indicated:

Year	Tax Deficiency	Interest	Total	Date Paid
1959	\$14,883.39	\$2,132.49	\$17,015.88	June 2, 1965
1960(H)	7,072.60	1,013.36	8,085.96	June 2, 1965
1960(W)	7,398.97	1,060.12	8,459.09	June 2, 1965
1961	14,496.50	2,077.06	16,573.56	June 2, 1965
Total	\$43,851.46	\$6,283.03	\$50,134.49	

6. Plaintiffs timely filed claims for refund for the years 1959, 1960 and 1961. The claims for refund were all disallowed on December 28, 1965. The present suit was timely filed, prior to said disallowance, on December 8, 1965, being more than six months after plaintiffs filed the claims for refund.

7. In the normal conduct of its business, Kelly-Generes Construction Co., Inc., executed many performances and payment bonds on individual construction jobs with Maryland Casualty Company and other surety companies acting as sureties.

8. In the course of conducting the business of Kelly-Generes Construction Co., Inc., an instrument entitled "Blanket Indemnity Agreement" with Maryland Casualty Company was executed on December 3, 1958, executed by the corporation as applicant, through Allen H. Generes, its President, and was signed individually by Allen H. Generes and William F. Kelly, as indemnitors.

9. In 1962 as the result of the aforementioned indemnity agreement, petitioner Allen H. Generes paid Maryland Casualty Company the sum of \$162,104.57 to reimburse Maryland Casualty Company for losses it sustained by virtue of bonds it had written for Kelly-Generes Construction Co., Inc.

10. The tax treatment to be accorded the payment by Generes as stated above forms the basis of this lawsuit.

11. It is stipulated and agreed between the parties that the amount of any judgment will be computed by the Internal Revenue Service, Audit Division, prior to entry of judgment, provided such computation does

not take longer than two weeks to compute and is subject to acceptance by plaintiffs.

8-9. The contested issues involve mixed questions of law and fact:

1. Whether the payment by Allen H. Generes to Maryland Casualty Company constituted a business or non-business expenditure.
2. More specifically, this issue is whether the obligation to pay gave rise to a business bad debt or a non-business bad debt under IRC § 166 (d). Secondly, the issue is whether such payment was a loss incurred in taxpayer's trade or business under IRC 165(c)(1) or a loss incurred in a transaction entered into for profit under IRC § 165(c)(2).
10. The following is a list and brief description of all exhibits (except documents to be used for impeachment only) to be offered in evidence by the respective parties. Each exhibit has been marked for identification and examined by all counsel:

1. Two depositions of Allen H. Generes, dated August 26, 1965, and April 29, 1966, respectively, with exhibits attached thereto.
2. Deposition of E. Kemp Cathcart, dated August 26, 1965 with exhibits attached thereto.
3. Deposition of Durel Black, dated August 26, 1965, with exhibits attached thereto.
4. Copy of "Blanket Indemnity Agreement" executed December 3, 1958.
5. Income tax returns filed by Edna Generes, wife of and Allen H. Generes for years 1959, 1960, 1961 and 1962.
6. Claims for refund filed by Edna Generes, wife of and Allen H. Generes with respect to the years 1959, 1960 and 1961.

The authenticity of these exhibits has been stipulated. However, all exhibits are subject to any objections that may be properly offered at the trial, other than respecting their authenticity.

If any other exhibits are to be offered by any party, they will be submitted to opposing counsel at least ten days prior to trial, and a supplemental note of evidence will be filed into the record of the case.

11. The following is a list and brief description of any charts, graphs, models, schematic diagrams, and similar objects which will be used in opening statements or closing arguments, but which will not be offered in evidence:

NONE

With respect to the items listed above, objections are made to their use as follows:

NONE

If any other such objects are to be used by any party, they will be submitted to opposing counsel at least three days prior to trial. If there is then any objection to their use, the dispute will be submitted to the Court at least one day prior to trial.

12. The following is a list of witnesses who *will* be called by the plaintiff:

Name Address

ALLEN H. GENERES
6500 Oakland Dr.
New Orleans, La. 70118

General Subject Matter of Testimony

Relation to Kelly Generes Const. Co. Inc. and motivation for signing bonds and indemnity agreement

E. KEMP CATHCART
1723 East 33rd St.
Baltimore, Maryland

Relation to Allen H. Generes and execution of bonds and indemnity agreement.

DUREL BLACK
5912 St. Charles Ave.
New Orleans, La.
WILLIAM F. KELLY
245 South Jamie Blvd.
Avondale, Louisiana

Relation to Allen H. Generes and execution of bonds and indemnity agreement.

Relation to Allen H. Generes and execution of bonds and indemnity agreement.

The following is a list of witnesses who *may* be called by the plaintiff:

PHILIP M. KELLY

ALLEN H. GENERES, JR.
5518 Pasteur Blvd.
New Orleans, La.
ALBERT H. WALKER,
Vice-President &
Director of Bonding
Division, Maryland

Relation to Allen H. Generes and execution of bonds and indemnity agreement

Relation to Allen H. Generes and execution of bonds and indemnity agreement

Relation to Allen H. Generes and execution of bonds and indemnity agreement

Cas. Co., Baltimore,
Maryland

ALLEN R. HOUK, or
other officer

Bank of New Orleans
935 Common Street
New Orleans, La.

Relation to Allen H. Generes and execution of bonds and indemnity agreement

The following is a list of witnesses who *will* be called by the defendant:

Name Address

ALLEN H. GENERES
6500 Oakland Dr.
New Orleans, La. 70118

General Subject Matter of Testimony

Relationship to Kelly-Generes Cons. Co. and motivation for signing indemnity agreement

WILLIAM F. KELLY
245 South Jamie Blvd.
Avondale, Louisiana

Relationship to Kelly-Generes Cons. Co. and motivation for signing indemnity agreement

The following is a list of witnesses who *may* be called by the defendant:

Name Address

ALLEN H. GENERES, JR.
5518 Pasteur Blvd.
New Orleans, La.

General Subject Matter of Testimony

Relation to Kelly-Generes Cons. Co.

PHILIP M. KELLY

Relation to Kelly-Generes Cons. Co.

E. KEMP CATHCART
1723 East 33rd. St.
Baltimore, Maryland

Relation to Kelly-Generes Cons. Co.

DUREL BLACK

Relation to Kelly-Generes Cons. Co.

5912 St. Charles Ave.
New Orleans, La.

Relation to Kelly-Generes Cons. Co.

If there are other witnesses to be called at the trial, then at least ten days prior to trial, the name, address, and the general subject matter of the testimony of each witness will be submitted to opposing counsel, and a supplemental note of evidence will be filed into the record of the case. This restriction shall not apply to rebuttal witnesses, the neces-

sity of whose testimony cannot be reasonably anticipated before the time of trial.

13. This is a jury case. If it is a jury case:

a. The following is a general statement of instructions to the jury that will be requested by the parties:

1. What constitutes a business bad debt as opposed to a non-business bad debt.

2. What constitutes an expenditure for protection of an employee's salary or employment status, so as to qualify for business bad debt treatment.

3. Generally what distinguishes an investor from one who is engaged in a trade or business with respect to one who devotes his activities to a corporation, and also guarantees its obligations or loans it money.

4. What constitutes a loss in a trade or business as opposed to a transaction entered into for profit.

Requested jury instructions shall be submitted by 5:00 p.m. Thursday preceding trial.

b. The following is a general statement of special questions that the parties will request the Court to ask the prospective jurors during the voir dire examination:

1. Have you ever had any controversy with the Internal Revenue Service that you feel was not satisfactorily resolved.

2. Have you ever had any dealings with Kelly-Generes Construction Co., Inc., and if so, of what nature.

3. Have you ever had any dealings with Allen H. Generes through Central Savings and Loan Association, and if so, of what nature.

4. Do you know any other members of the family of Allen H. Generes or Edna Generes.

14. The following amendments to the pleadings are requested:

NONE

15. All discovery procedures have been completed except the following:

NONE

16. Counsel suggest the following additional matters to aid in disposition of the action:

NONE

17. Counsel estimates the length of the trial will be one day. The trial of this case will commence on the 14th day of August, 1967, at 9:00 A.M.

18. This pre-trial order has been formulated after a conference at which counsel for the respective parties appeared. Reasonable opportunity has been afforded counsel for corrections or additions prior to signing. However, this order will control the course of the trial, and it may not be amended except by consent of the parties and the Court, or by order of the Court to prevent manifest injustice.

19. Possibility of settlement of this case was considered.

(Signed) ALVIN B. RUBIN
United States
District Judge

(Signed) MAX NATHAN, JR.
Attorney for Plaintiff

(Signed) PETER WINSTEAD
Attorney for Defendant

MINUTE ENTRY:
AUGUST 24, 1967
RUBIN, J.

EDNA GENERES, WIFE OF AND
ALLEN H. GENERES

SECTION "C"
versus
NO. 16156
CIVIL ACTION

UNITED STATES OF AMERICA

This cause came on this day for trial.

PRESENT: MAX NATHAN, JR., Esq.
Attorney for Plaintiffs
LOUIS C. LACOUR, Esq.
U. S. Attorney
ELAINE CHAUVIN,
Asst. U. S. Attorney
PETER WINSTEAD, Esq.
Atty. Tax Division
Dept. of Justice

All present and ready.

Jury called, sworn on their Voir Dire, and being found acceptable, sworn to truly try the case.

JURORS

Mrs. Shirley Cavalier
Salvadore Conte
Mrs. Peggy LeBlanc
Mrs. Margaret Decareaux
John A. Williams
Mrs. Delphine Price
Mrs. Marjorie M. Farley
Manuel M. Romero
Mrs. Florence M. McKinney
Aylward Coyle
Kesley C. Clark
Mrs. Violet M. Garel

ALTERNATE JUROR

Mrs. Marion Z. Bonomo

Balance of Jury Panel excused subject to call.
The Court instructs the Jury that they shall not discuss

the case among themselves or with others, etc. until the case is given to them for deliberation.

Counsel for plaintiffs addresses the Jury.

Counsel for defendant addresses the Jury.

The following witness is called to testify on behalf of Plaintiffs:

Allen H. Generes, Sworn by Deputy Clerk.

Testimony of Plaintiffs' witnesses continues:

Allen H. Generes, Previously Sworn, Recalled.

Durel Black, Sworn by Deputy Clerk.

The deposition of E. Kemp Cathcart read to the Jury, but discontinued as the Court rules that the testimony is accumulative.

Testimony of Plaintiffs' witness continues:

William F. Kelly, Sworn by Deputy Clerk.

Counsel for Plaintiffs rests.

Jury excluded from the Courtroom for hearing on motions.

Counsel for Defendant orally moves for a Directed Verdict, on which the Court RESERVES RULING.

Counsel for Defendant rests.

Counsel for Plaintiffs files written motion for Directed Verdict; on which the Court RESERVES RULING.

Jury called and returned to the Courtroom.

Argument.

Alternate Juror excused subject to call.

Argument.

Rebuttal.

Jury charged and instructed by the Court and retires to deliberate.

Jury returns into the Court for further instructions.

Court gives additional instructions to the Jury.

Jury again retires to deliberate.

Jury again returns into Courtroom.

The Court once again gives additional instructions to the Jury.

Jury again retires to deliberate.

IT IS ORDERED BY THE COURT that the two questions previously received from the Jury be filed and made part of the record.

Jury returns into the Courtroom and renders the following Verdict:

VERDICT

"We, the jury in the above matter, unanimously find as follows:

Do you find from a preponderance of the evidence that the signing of the blanket indemnity agreement by Mr. Génères was proximately related to his trade or business of being an employee of the Kelly-Genères Construction Company?

Yes

New Orleans, Louisiana, this
24 day of August, 1967.

(Signed) **WESLEY D. CLARK**
Foreman of the Jury'

Counsel for both parties waive polling of the Jury.

The Court orders the verdict be recorded and made the Judgment of the Court.

Court adjourns.

[1] IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF LOUISIANA
NEW ORLEANS DIVISION

Filed: Nov. 29, 1967

EDNA GENERES, WIFE OF AND ALLEN H. GENERES

versus No. 16156
CIVIL ACTION

THE UNITED STATES OF AMERICA

TRANSCRIPT OF PROCEEDINGS

APPEARANCES:

MAX NATHAN, *Attorney for Plaintiffs*

PETER WINSTEAD, *Attorney for Defendant*

(The above entitled and numbered cause came up for hearing on August 24, 1967, in the Courtroom at 400 Royal Street, New Orleans, Louisiana, the HONORABLE ALVIN B. RUBIN, District Judge, presiding.)

[2]

PROCEEDINGS

TRANSCRIPT OF PROCEEDINGS

THE COURT: Be seated, please.

Will the Clerk call the first case on the docket for this morning.

THE CLERK: 16156, Civil Action, Edna Generes, wife of and Allen H. Generes versus the United States of America.

THE COURT: Is the plaintiff ready to proceed, Mr. Nathan?

MR. NATHAN: We are, your Honor.

THE COURT: Defendant ready to proceed?

MR. WINSTEAD: We are, your Honor:

(Whereupon, twelve jurors and one alternate juror were empaneled and duly sworn for service.)

THE COURT: Ladies and gentlemen, I have to talk to you just a few moments and when I finish we will recess Court a few moments and at that time all the others have been called will be excused. I will ask you to remain in your seats just a few moments so you won't interrupt Court at this time.

Most of you have served on juries previously and I think

know most of what I am about to tell you, and some of you have not and, therefore, I think a few words to those few of you will be appropriate. [3] First, for the benefit of all of you, it's likely that this case will be completed today however, in the event that it's not, we have asked Mrs. Bonomo to serve as an alternate juror because if this case for any reason should carry over to tomorrow we would like to have an extra juror in case someone becomes ill. However, in all likelihood we will finish the case today.

Now, as soon as I finish these few preliminary remarks, I will excuse you for a few moments so you can call your homes or offices and you can tell them you are going to be serving on the jury and won't be back today.

Our normal procedure will be that we will recess for lunch about 12:30 and resume Court about 1:30. We will stop at some convenient time in the testimony and it may be approximately earlier or later than the times that I have given you.

Cases of this nature proceed in exactly the same manner as any other civil lawsuit. We will start with an opening statement by the plaintiffs in which they will tell you what they expect to prove, and an opening statement by the defendant in which the defendant will tell you what it expects to prove.

Thereafter, the plaintiff will call the plaintiff's witnesses in an effort to prove the plaintiffs' case. Each witness will in turn be subject to cross-examination by the [4] Government.

Following that, the defendant, the United States Government, will call its witnesses and they will be subject to cross-examination by the plaintiff.

When you have heard the testimony of all the witnesses, the lawyer for each party will be given a chance to argue his case to you in what is called a closing argument, and you will then have instructions by me concerning the law that you will apply in resolving the questions submitted to you.

As the jury, it will be your decision that will determine the facts in this case, and you are the sole judges of the facts and based on your determination of the facts, applying the law as I give it to you in my instructions, you will determine the outcome of this lawsuit.

I know that for each of you it is a matter of some incon-

venience to sit on this jury today rather than to be doing something else that you would perhaps prefer to do, but I think it appropriate to call your attention to the fact that each of us is protected by a constitutional guarantee of a right to trial by jury anytime you are involved in a lawsuit whether it be civil or criminal. This is a protection that the United States Constitution gives to everyone of us. Obviously, none of us can have this right unless his fellow citizens are willing to serve on a jury and accord it to him. [5] In serving on a jury, therefore, you serve an important role in the administration of justice, and in the deciding of controversies not only between private citizens but as in this case between a private citizen and the United States of America.

I need hardly remind you, I think, that there are few places in the world where a private citizen can have private citizens adjudicate an argument he may have with his Government and where both are accorded equal status and he has a right to have his case decided by a jury of his peers.

Now, I know each of you will want to make a phone call. There is a public telephone down the corridor, the Marshal will show you where it is. My office is immediately to the right of the courtroom when you leave, and my library is immediately to the left of the courtroom when you leave and there is a telephone in each place. By the use of these three phones, I think each of you can make a phone call fairly promptly and as soon as you have had an opportunity to do this we will resume Court and at that time we will commence with the statements of lawyers.

Before we recess, those of you who have been called as witnesses in the case when the Court is convened will you please remain in the corridor until you are called. While you are waiting a call, you should not discuss this case amongst yourselves or with anyone else other than, of course, the [6] lawyers for the plaintiff or the United States.

I would like briefly to say to each of you who have not served on a jury previously, and to remind those of you who have, that you should not discuss this case during the trial with anyone and you should hold no discussions at all with any of the parties or witnesses even though your discussions with these parties or witnesses might be perfectly innocuous like whether it is going to rain today. If the jurors talk to anyone involved in the case, it leads to the

possibility of some suspicion on your part, so we ask you to refrain from any discussion with anyone in the case anyway.

After, the case is over, you should not discuss your verdict or the way in which it was arrived at with anyone at all unless you are satisfied that that person has the authority of the Court to interview you. This is a rule adopted by this Court as a matter of protecting the jury from inquiries and as a matter of protecting the confidentiality of your deliberations. Should you be approached during the trial by anyone you should, of course, report that matter to the Court.

Thank you very much. We will now stand at recess for ten minutes.

(Short recess taken.)

THE COURT: Be seated please.

Mr. Nathan, are you ready to proceed with your opening statement?

[7] MR. NATHAN: We are, your Honor.

THE COURT: Go ahead.

MR. NATHAN: Your Honor, may I ask do you want us to stand behind the podium?

THE COURT: You may do either in addressing the jury; and while examining the witnesses, I would like for you to use the podium because we find that otherwise the witnesses don't talk loudly enough for the jury to hear.

MR. NATHAN: It's all right if I stand up here for the jury to hear?

THE COURT: Yes.

Are there witnesses still in the courtroom, persons who will be called as witnesses in this case?

MR. NATHAN: No, your Honor.

THE COURT: Thank you.

MR. NATHAN: Ladies and gentlemen of the jury, as the Judge told you, this trial today is a suit for refund of taxes that have already been paid.

My name is Max Nathan. I am the attorney for the plaintiffs, Mr. and Mrs. Allen Genères.

Mr. Genères is sitting here in the blue suit and sitting at the end of the table is his wife.

I think at the outset I should tell you that the basic facts in the case are not really in dispute. You will find that the

Government and the plaintiffs are in agreement [8] on most of the facts that took place, so you will not have a difficult problem, I think, of sifting out what are the facts. It's not like an ordinary accident where you have a question of which car collided and what have you. Here we are in basic agreement on the facts. The question is going to be the importance of the facts, which facts are more important and that will be the problem that you will have to consider.

Mrs. Generes is only in the lawsuit because she is married to Mr. Generes. She did not participate in any of the activities that are involved here, but because she is married to him she filed joint returns with him and consequently everything that applies, applies to Mr. Generes and Mrs. Generes, but she is not going to take an active part in the trial itself.

One thing I am happy to tell you is that you do not have to worry about the figures. In fact, the amount of the tax you will not have to compute anything here. You will not have to—about how much the refund should be, the figures there is no dispute over.

What happened, the incident giving rise to this litigation, is that Mr. Generes in the year 1962 paid Maryland Casualty Company approximately \$162,000. This payment was made pursuant to a legal obligation that he had to pay. There will be no dispute over whether he should have paid the amount or not. He was—and the Government agrees with us, [9] he was legally obligated to pay this \$162,000. What happened is that he paid this money and on his income tax returns for 1962 he claimed that payment as a business bad debt deduction. He did not have anywhere near that amount of income for the year 1962, so that he had a greater deduction than he had income. The result was that if this is a business bad debt, as we claim, under the law and there is no dispute about the law on that, under the law he can then carry back the part of that deduction that has not been used on the years 1959 and 1960 and 1961.

This is known in law as a net operating deduction. It is only available for business bad debts.

The Government—Mr. Generes, I might say, had more of a deduction than he had income, so he carried back. The Government disagreed with Mr. Generes' contention that this was a business bad debt. The Government contends that it is a non-business bad debt.

Now, you don't have to worry about whether you can carry back and how much more the deduction was over the income, we don't get into any of those problems.

If you find that this was a business bad debt, then everything else falls into place and the Judge will handle that.

If you find that it is a non-business bad debt, then he does not carry back and everything falls into place. [10] So, ultimately this case is going to boil down to one question; was it a business bad debt or was it a non-business bad debt?

Naturally, we contend that it is a business bad debt.

I might say this at the outset, too, when we say that this is a business bad debt, therefore, this is deductible, I want to make it clear that we are not asking for special favors from the Government, that is not the situation. The question here is if this is a business bad debt, if it is properly categorized as a business bad debt, then Mr. Generes is, under the law, entitled to carry back. If it is not a business bad debt, he is not entitled to carry back, and if he is not entitled to it, he doesn't want it.

It's not a situation of trying to take advantage of any loop holes in the tax law. This is not the case at all. This is a recognized statutory provision. The only question is what are the facts, do the facts say you get a business bad debt or non-business bad debt. I want to set that in prospective so you understand exactly where we go from here and why we say this is a business bad debt.

In the case today, we will start off—I will call Mr. Generes to the stand. Mr. Generes is a man eighty-one years old. He will be eighty-two in October. He has been in the construction business for many years of his life. He [11] started out as a very young man in the construction business. Now, he branched out into other businesses and later on in his life and he still has been ever since its inception, he is the President and General Manager of Central Savings and Loan Association.

Now, he makes a salary for being President of the Central Savings and Loan Association. Like many men, he has more than one trade or business. He also stayed in the construction business and in the early 1940's, during World War II, Mr. Generes formed a partnership with his son-in-law, a man by the name of William F. Kelly. We will probably refer to him as Bill Kelly.

Mr. Generes had three children, two daughters and a son. One of his daughters married Bill Kelly and Bill and Mr. Generes went into business together in construction. They built residences and the business expanded after the war and they went into municipal construction, streets, sewer lines, waterworks and their business grew and expanded and ultimately in 1954 Bill Kelly and Allen Generes incorporated, prior to that time they had been doing business as general partners.

In 1954 they incorporated and they used the name Kelly-Generes Construction Company, Inc.

Now, this made a big difference when they incorporated in 1954, and let me explain to you why. In the construction business [12] one of the necessities of the business, so we will contend and I don't believe there is any dispute, is that bonds are needed. If a contractor gets a job that is to be performed, he may have to have that job bonded.

Now, what do we mean? There are payment bonds and performance bonds. A payment bond let's say guarantees that the job when it is finished will be paid for, all labor and material, there won't be liens on the job.

A performance bond guarantees that the job will be completed. When you have a contract for the city, state or federal, bonds are required, you can't even bid without a bid bond, and when you get the job, you have to put on a bond and you have to guarantee that the job will be completed. Now, this is an essential of the construction business.

If you build homes, you will probably be familiar with this. A contractor, you say you want him to build a house, you want to be sure there will be no liens filed. You tell him, I will build the house, I want a bond guaranteeing if anything happens to you or if you don't pay the people that are working for you that the bonding company will stand behind you. You want somebody besides the contractor himself to be responsible to you. Homeowners require it, lenders require it, mortgage holders all the time require this generally as a matter of course, and in municipal work it's required under the law.

[13] Well, throughout the years when Mr. Generes was doing business as a partnership there was no problem with bonds. He would simply go to a bonding company, Maryland Casualty or U.S.F.&G., one of the nationally known bonding

companies, say, "We need a bond, we bid on a job and we need a bond to handle it." They were doing business as partners, all of their assets, everything, was involved in the partnership in the sense as a partner they were both liable for the full extent of whatever might happen: but when they incorporated, when you have a corporation you have what we call limited liability.

This means that if I am doing business as a partner and we incur expenses I could be held to pay the whole amount; but if you and I form a corporation and that corporation runs up expenses, all you can do is go against the corporation and it is limited—the creditors are limited, they cannot go beyond the corporation; and if the corporation has no assets, then the creditor is out of luck.

Well, when Mr. Genères and Mr. Kelly incorporated in 1954, the bonding companies then said, "If you want us to write bonds for you on these jobs anymore you, Allen H. Genères, are going to have to sign an agreement to be personally liable if we get called on." If your corporation wants a bond, you get a job let's say and we bond it and we guarantee to the City of New Orleans that you will perform that job [14] and then that corporation defaults, then we want a guarantee from you and we want one from Bill Kelly saying that you will pay us back for whatever we get stuck for.

Without this indemnity agreement is what it is called, and you will be hearing that word over and over and over again today, without that indemnity agreement the surety companies say no dice, we will not write a bond if you will not agree to be personally liable. Consequently, Mr. Genères signed an indemnity agreement saying to Maryland Casualty Company if you will write a bond for Kelly-Genères Construction Company, Inc., I will agree to pay you back if you suffer any losses.

Well, Kelly-Genères did very well and everytime they got a job Bill Kelly and Mr. Genères signed the indemnity agreement. They got a bond and did the job. Over the years that company built up, beginning in the early 1940's, by the 1950's they were performing over a million dollars worth of work a year and in 1958 they found it too cumbersome to get to Allen Genères everytime they wanted to bid on a job to have him sign the agreement and each time he

had to sign it. So they said they wanted a blanket agreement and if you will write bonds, anytime you do so, I will agree to be bound. This means from then on forth anytime you write a bond Allen Generes is on the hook personally to Maryland Casualty.

Mr. Generes signed this agreement, Bill Kelly sign- [15] ed it also. We will have a photostat of the agreement which will be introduced into evidence. You will not have to worry about reading it, and I think I can safely say without fear of correction from the Judge or counsel that it was pursuant to this indemnity agreement that ultimately Allen H. Generes had to make that payment of \$162,000 and there is no doubt it was legal and he was bound to pay. You won't have to read the agreement in full.

In 1958, as I say, about four years after they incorporated, Allen Generes signed the indemnity agreement and Maryland Casualty Company gave an increased line of credit and said we will write bonds up to \$2,000,000. The company was doing very well and making money and they continued to handle business continued to expand.

Then, unfortunately, in the year 1962 the company grossly underbid on a couple of jobs. What this means is that the company agreed to perform a job for a certain price and became legally obligated to do so and then found that it could not perform at that price. The result was that Kelly-Generes Construction Company went to—under the circumstances it flatly went busted, and when they went busted they went busted pretty heavily because Maryland Casualty Company got called upon pursuant to the bonds it had written and Maryland Casualty Company had to pay out well over \$300,000.

Bill Kelly had to pay his half and Mr. Generes had [16] to pay his half because when Maryland Casualty Company paid—when the people who had the jobs said that Kelly-Generes defaulted, Maryland Casualty Company you have to perform, Maryland Casualty Company stepped in and performed and then turned to Generes and said it cost us—and Mr. Generes' share was \$162,000 to finish what Kelly-Generes defaulted on. Maryland Casualty Company went to Allen H. Generes and said you have to pay off under the indemnity agreement you signed.

In 1962 Kelly-Generes became defunct. Allen H. Generes

—Maryland Casualty Company was called upon under its bonds to finish the job, they paid them, and then turned to Mr. Generes and Mr. Kelly and collected from Allen H. Generes in the year 1962 \$162,104.57, and I am happy to say you don't have to worry about all those figures.

It was \$162,000 in 1962 that Allen Generes, as I said, claimed that as a business bad debt deduction, and then because his income was no where near \$162,000 he carried back and that is the issue then, is this a business bad debt deduction, is this properly related to Allen H. Generes' business.

All right, we contend that it is, and we will try to prove this to you through the testimony of these witnesses, through Mr. Allen H. Generes, himself, through Mr. Durel Black who was the insurance agent for Black Company and president of Maryland Casualty Company, and through the deposition of Mr. Kemp Cathcart, he is living in Maryland, unfortunately [17] a man in his seventies and unable to be here for the trial, we have taken his deposition and it will be read to you so you will know his testimony, and Mr. William Kelly, who, as I say, was a partner and co-stockholder in Kelly-Generes Construction Company.

Now, very briefly then and this almost concludes my talk to you, I do want to say in this opening statement that one thing I want to point out particularly is that Allen Generes was almost at all times here in the lawsuit the president of Central Savings and Loan Association. We don't deny that and there is no dispute on that. He still is president of Central Savings and Loan and that is a trade or business that he has, but he was also the president of Kelly-Generes Company and he owned 45% of the stock in Kelly-Generes and he had an investment of \$38,900 in Kelly-Generes Construction Company.

Now, our position in the lawsuit is that Allen Generes had as an additional separate trade or business that of being a corporate officer of Kelly-Generes Construction Company. There is no problem about Central Savings and Loan. There is nothing wrong with having more than one trade or business. Just as I may practice law during the day, I may train German Shepherds at night. This would be separate. The law recognizes, and there is no dispute on this, the law recognizes that a man may have more than

one trade or business. [18] In fact, I think you will find there is no disagreement between the Government and us that Allen H. Generes had as a trade or business rendering service for pay as an officer of Kelly-Generes Construction Company. So you see that they are not that much in dispute here.

The real question is, was the execution of that indemnity agreement related in such a way, and the Judge will charge you on this point, was the execution of that indemnity agreement related in such a way to his trade or business as an officer of Kelly-Generes Construction Company so that he is entitled to claim it as a business bad debt, and that is the problem you will have to decide.

Our position will be that in the construction business it is the nature of the business that bonds are required, without such bonds, there can be no business.

Our position is that where you have a corporation, the bonding companies will not write bonds without the personal guarantee of these men that the—the guarantee of Allen Generes was required and that if Allen Generes had not executed that indemnity agreement there would have been no business, there would have been no business, there would have been no company, there would have been no salary, and Mr. Generes was making a salary of \$12,000 a year.

He made this salary from the time they started the business throughout until the year the company went—went [19] busted; and our position is that it was related to his trade or business. As an officer, it was to protect his salary of \$12,000 a year that Mr. Generes signed the indemnity agreement and, therefore, we believe, and I hope that you will find, that this is a business bad debt.

I ask you only to listen to these witnesses because I recognize that this is a very technical—technical matter. We are talking about some sophisticated terms, but we hope that you as jurors will bring your common sense to bear and concentrate on what these witnesses have to say so that you can understand, and I ask you to try to pay special attention to that, to the nature of the construction business, the nature of the bonding requirements that are made, the nature of Mr. Generes' job as an officer of Kelly-Generes, for which he received a salary of \$12,000 a year; and then

I hope that in your good judgment and in your deliberations you will agree with us that this indemnity agreement was so related to his trade or business as an officer of Kelly-Generes Construction Company that he is entitled to the business bad debt deduction.

Thank you.

THE COURT: Mr. Winstead.

MR. WINSTEAD: Ladies and gentlemen, let me first say that I hope you noticed from the claps of thunder, which occurred during Mr. Nathan's opening statement.

[20] I am an attorney with the Department of Justice, Tax Division, and this is Miss Chauvin with the United States Attorneys' office here in New Orleans.

Now, the word "tax", when I say that you immediately say income taxes. I know it's an ugly word to all of us sometimes, especially April 15 every year.

As they say, there is nothing more certain than death and taxes, and we will have to live with them.

Let me say, also, I think it important for me to make something more clear to you. This is not a criminal case. I know when I tell people what I do, that I work with the Justice Division, Tax Department, they say who are you going to put in jail next. This is not a Bobby Baker type case. It is not a criminal type case. As the Judge told you, it is a civil case. As he told you, also, every citizen has a right to come in and have a legitimate dispute with the Government, with the Internal Revenue Department over the appropriate characterization of a deduction on a tax return or anything else. This is, as I say, a civil matter, a disagreement between the parties as to the appropriate interpretation of the revenue law, and neither Mr. or Mrs. Generes in any way will be fined or punished or sent to prison or anything else as a result of this lawsuit. I want to get this firmly in your minds, we are not accusing Mr. and Mrs. Generes of tax evasion or avoidance of any kind, we just [21] think they are not entitled to this particular net loss carry back, you heard Mr. Nathan explain this in very clear terms.

Let me also say that we are not trying to collect more taxes from these people. It is our position that they have paid all the taxes they owe.

What we dispute is their right to obtain a portion of

these taxes back. We think they paid all the taxes which they owe.

Let me also say that I don't have any personal interest in the lawsuit in that I stand to gain any money because of the outcome. The Government thanks me every two weeks for this job and I have no personal interest in the amount of money in the lawsuit or your verdict.

And as Mr. Nathan told you, and I think I want to make this clear to you, we have allowed Mr. and Mrs. Generes a deduction for this payment and as Mr. Nathan says it's substantial, \$162,000, that's a lot of money we have allowed him to deduct for that, but we have allowed it as what we contend it to be, a non-business bad debt deduction, and the reason why the plaintiffs contend it's a business bad debt deduction is so it can be entitled to the advantage of a net operating loss carry back. You need not be concerned with the mechanics of that.

Let me say this that Congress has sought to limit those deductions which are entitled to this advantage of a [22] net operating loss carry back. You have excessive deductions that you can go back three years and pick up your income tax returns from the years past and use those deductions on that return and get a refund of prior taxes, and Congress has sought to limit this deduction, and that's the reason for the distinction between business deductions and non-business.

Let me also say this to you, if you just walked up to anybody and said, what's a non-business bad debt? I think their first reaction would be, it's where my brother-in-law loans me money or I give it to my sister to buy a car, between friends, it doesn't have a business motive. The Judge will instruct you today that the term "non-business" is really used as opposed to the word business and non-business covers many, many debts between lenders who are legitimately trying to make money on their debts by loaning money, they want to collect interest, they are made for reasons where the lender hopes to get income from doing it, it's not just a percentage, it's not a bona fide loan or anything, it refers to many debts that are legitimate.

Now, as Mr. Nathan told you, the specific question that you are going to be called upon to answer is whether Mr. Generes' signing of this indemnity agreement and

particularly the blanket indemnity agreement in December of 1958 was proximately related to his trade or business of being an employee of Kelly-Generes Construction Company. [23] Now, this determination of the word proximately, I know you probably have a hard time putting any meaning in that, I think this determination will be made in terms of what motivated Mr. Generes in signing the indemnity agreement, I think that is where you should focus your attention when you hear the evidence in this case.

Now, the test is whether Mr. Generes did it to protect his salary of \$12,000 per year or did he do it to protect his investment in that Kelly-Generes Construction Company that was doing a million dollars worth of business at this time. Now, this is the question, what was his motivation in doing it? And our position is, ladies and gentlemen, when you hear the evidence you will conclude that Mr. Generes' motivation was to protect a substantial investment in the company in which members of his family were involved in or was it in the company to which he had loaned a tremendous amount of money in which he had stock in which he hoped would go up in value and would pay dividends, all of these things, his investment in Kelly-Generes Construction Company and we contend that these things make up the primary and most important reason why he signed the indemnity agreement to keep that company going earning money and paying dividends, the stock going up in value and things of this nature, and not protecting his salary. We don't think protecting his salary was a significant motivating factor. You know \$12,000 is a lot of [24] money. I am sure I don't make \$12,000 a year. I am sure it would be very important to me and all of you, but you have to view this in the context of Mr. Generes, what he was interested in, what his situation was at the time he did this, what would have motivated him to sign this blanket indemnity agreement, and we think you will conclude that his salary was of little concern, of course, it was a concern but not sufficient to sign the indemnity alone just to get the salary; he was interested in that company and keeping it going and protecting his investment in it.

Now, I think I should also, in addition to pointing out what a non-business debt is, I want to also make something else very clear to you. I hope I can, because it's a rather

hard thing to grasp even for me, but I think the Judge will charge you that there is a distinction in the law, the Supreme Court has told us this, between the trade or business of a corporation like Kelly-Generes Construction Company and the trade or business of the people who work for that company.

Now, you must keep this distinction in mind. Now, Kelly-Generes Construction Company is in the construction business, there is no question about that, and they need bonds and they need indemnity agreements signed by people to be in that business. Now, Mr. Generes works for the company, but Mr. Generes is not in the construction business, his company is in the construction business. His business is being an employee [25] and it's those acts of his as an employee to protect his status as an employee and protect his rights to receive the salary that you would be concerned about. I want you to keep that distinction clearly in your minds.

Now, as Mr. Generes—excuse me—Mr. Nathan said, a lot of the facts in this case we don't have any quarrel with, they are just not—just not disputed.

The first is that Kelly-Generes Construction Company needs bonds to get construction jobs. This is—that is just a fact of life in the construction business. We don't intend to dispute that. When Mr. Black testifies about it, we have no quarrel about it, but what we do say is that Mr. Generes' motivation in signing the indemnity agreement on behalf of the corporation was done to protect the company, to keep it going, to—to insure that his investment and the money that he loaned to that company continued to be good, so he didn't lose those, these are the things we think motivated Mr. Generes and we think when you hear the evidence you cannot help but conclude that he was primarily attempting to protect that investment rather than the right to receive the \$12,000 per year salary from that company and be an employee of it.

Now, there are several factors that I want you to focus your attention on. The first is—we are talking about a man's motivations and people are motivated by things that happen to them, events and occurrences that occur, and [26] these are the things that cause people to do things and so these are some of the factors I think you should look at.

The first is, was Mr. Generes ever threatened by anyone in the company, his employer, anyone with the loss of his job and salary if he didn't sign these indemnity agreements?

This would have motivated him to do it if someone told him; if the employer said, you are going to be fired if you don't and your salary will be cut off.

In the evidence I want you to see if you find any evidence that he was threatened with losing his job if he didn't do it. Of course, he was threatened indirectly. If he didn't sign the indemnity agreement, Maryland Casualty Company wouldn't issue bonds, Kelly-Generes Construction Company couldn't get construction contracts, therefore, it would go out of business and all the employees would lose their salaries because the company just wouldn't be in existence then.

It is our position, this is a factor you should consider, we think this is too remote, it is not proximate to Mr. Generes' objective of attempting to secure the continued payment of his salary. We think that this is just too remote and it was done in the nature of an investment to save his company and indirectly, of course, to protect his salary.

Now, the second thing I want you to consider is Mr. [27] Generes' position or status with this company. Was he the person who could control his own employment, his own salary went up and down, whether he was fired? He was president and I think the largest single stockholder in a family corporation with other members of his family, relatives. Now, is this a man who is worried about the continuation of his salary if he doesn't do something and sign these indemnity agreements?

We think you will find from the evidence that he had control over all these matters. I think it is a very important factor to know what motivated him.

The next thing that I think is important is what motivated a man to sign an indemnity agreement or anything else to protect his job, it would be the fear of unemployment, that he couldn't get another job, so I will sign the indemnity agreement so I can keep my job.

Now, was Mr. Generes threatened with unemployment, a man of his age out in the street without work?

I think you will find that Mr. Generes is fairly well off. He paid \$162,000 to Maryland Casualty Company and also

—and most important in talking of protecting your salary and job consider this, ladies and gentlemen, the evidence will show you, too, that Mr. Generes was the full-time president and an employee of Central Savings and Loan, for which he received another salary of \$19,000 per year. I [28] think you will find he had some other sources of income to lead you to believe he is not a man worried about protecting this \$12,000 salary.

Let me ask you to focus your attention on this, also, I am sure any of you who work probably put in a forty-hour week. I want you to consider how much time Mr. Generes put into the job that he tells you that he is trying to protect. I think the evidence will show you it amounted to about one hour per week.

Now, another factor you should consider is just how much Mr. Generes had invested in the company, what would he be protecting as far as his investment in the company?

I think you will find that here is a company doing a million dollars worth of business with substantial assets and investments in the company, loans to it, total these up and see what really was important to Mr. Generes.

Now, I am sure you will hear Mr. Generes tell you that the receipt of \$12,000 salary was important to him. I just don't think anybody could say it wasn't important to him, an additional \$12,000 a year would be important to anybody, but, as I say, I want you to consider how important it was to this particular man in his position within his capacity with his company. How important was that salary to him as opposed to his family corporation with his son in it, two brothers-in-law working in it, a company in which he had an interest [29] in keeping going because his own children were receiving salaries from it and they had stock in it?

Now, these are the factors I want you to consider in deciding what motivated Mr. Generes in signing this indemnity agreement.

Now, I think that this will be a very short trial and I think that you will all be home well in time for dinner tonight.

The Government doesn't have any witnesses to present to you because obviously in this situation the people involved in this are Mr. Generes and the people in his business and the man from the indemnity company, there is nobody

else that knows anything else about this, that's why we don't have any witnesses coming in and calling anybody a liar.

I think you will find that the facts are largely undisputed, so we will not quarrel with them.

Let me also say I want to thank you for coming down here today and taking the time to sit here and hear this case. I really do appreciate it.

Thank you.

(Conference between Court and counsel at the bench.)

THE COURT: Plaintiff ready to call his first witness?

MR. NATHAN: We are, your Honor.

ALLEN H. GENERES,

[30] called as a witness at the instance of the plaintiff, after being duly sworn, was examined and testified as follows:

MR. NATHAN: Mr. Generes, will you try to talk into the microphone, I will go back over here.

THE COURT: Mr. Generes, just talk and the microphone automatically will pick it up.

DIRECT EXAMINATION

By MR. NATHAN:

Q. What is your full name, Mr. Generes?

A. Allen H. Generes.

Q. How old are you, Mr. Generes?

A. I will be eighty-two on the 16th of October.

Q. Are you married?

A. Yes, sir, I am.

Q. What is your wife's name?

A. Edna P. Generes.

Q. Is she sitting in the courtroom?

A. Yes, sir.

Q. Would you point her out please?

A. At the end of that table (indicating).

Q. How long have the two of you been married?

A. I think it's about thirty odd years.

Q. And you are still living together?

A. Yes, sir.

Q. At all times that were relevant in the lawsuit you [31] were man and wife?

A. Yes, sir.

Q. What is your occupation, Mr. Generes, at the present time?

A.. At the present time I am President of the Central Savings and Loan Association.

Q. Where is that located?

A. 624 Canal Street.

Q. How long have you been President of the Central Savings and Loan Association?

A. I organized it in 1937.

Q. Do you have any other occupations?

A. Well, other than being on the board of the National American Bank, a trustee of the Touro Infirmary and a director of the Gulf National Gas Company, I have no other occupations.

Q. Have you ever been in the construction business?

A. I entered the construction business in 1909 in Oklahoma City.

Q. Mr. Generes, perhaps it would be easier if in your own words you would tell the jury—give them a brief statement of the facts surrounding the time you went into this business and what you did and how you developed, bringing them up to the construction company that is involved in the lawsuit?

A. In 1909 I left New Orleans and went to Oklahoma [32] City thinking that the grass was greener there and that I would really make some money.

When I got out there, I found out that the grass was hay and I got a job as an ordinary common laborer rolling crushed stone to a concrete mixer. My salary was 25¢ an hour, working an eight-hour day when we worked.

Q. And what did you do from there, Mr. Generes?

A. And then my wife, she didn't care for Oklahoma, she was on a train between Oklahoma City and New Orleans half the time, so I concluded it was best to return to New Orleans so she would be happy and satisfied. I did—

Q. Mr. Generes—excuse me—what was the kind of work that was—what was the name of the company that you were working for?

A. The Cleveland Trinidad Construction Company. We did street paving, sewer work, drainage and surfacing.

Q. How did that work compare with the kind of work done by Kelly-Generes Construction Company?

A. Paralleled.

Q. After you returned to New Orleans, what did you do?

A. I came here with the idea of going into a construction business but when I arrived here I found out that one concern had practically a monopoly on the work, and I decided not to invest any money here in that particular line of business because I knew I was butting my head up against a [33] stone wall.

I then went into the real estate business, working for the Baccich & DeMontluzin Real Estate and I stayed with them until 1923 when I opened up my own office under the name of Generes & Ganuchea Corporation.

Q. What was the nature of that business?

A. Real Estate.

Q. When did you and Mr. William F. Kelly first go into the construction business, Mr. Generes?

A. I think, Mr. Nathan, it was in 1943.

Q. During World War II?

A. Sir!

Q. During World War II?

A. During World War II.

Q. Let me ask you this, Mr. Generes, who is William F. Kelly?

A. He is my son-in-law, he married my eldest daughter.

Q. How many children do you have?

A. Three.

Q. How many girls and how many boys?

A. I can tell you the number of grandchildren I have—

Q. No, children—you have how many children?

A. I have three children, two daughters, and a son.

Q. And Mr. William F. Kelly is your son-in-law?

A. He's my son-in-law.

[34] Q. What kind of business was it that you formed with him in 1943, Mr. Generes?

A. General contracting, utility work.

Q. What was the name of the company?

A. At that time when we went in with William F. Kelly, the name was William F. Kelly Company.

Q. And was this operated as a partnership or corporation?

A. Partnership.

Q. Was the name of this company ever changed?

A. Yes, sir.

Q. What did you change it to?

A. Changed it to Kelly-Generes Construction Company, Inc.

Q. Didn't you change it to Kelly-Generes, Inc., or just Kelly-Generes Construction Company?

A. The corporation was later, Kelly-Generes and later on in years why we decided to incorporate it.

Q. Approximately when did you change the name from William F. Kelly Company to Kelly-Generes Construction Company leaving off the incorporated?

A. I think it was in about 1948.

Q. In the late 1940's?

A. Yes.

Q. What was the nature of the work performed by this [35] partnership, Kelly-Generes Construction Company?

A. Laying sewers, drainage, gas lines, and water mains.

Q. Street paving?

A. Street paving.

Q. Did you ever build any residences?

A. In 1943 or 1944 we built about 240 houses for immigrant workers.

We got to need help here and needed houses, so we built 240 or 250 houses that year.

Q. In the construction work that Kelly-Generes did, did you have occasion to require bonds?

A. Mr. Nathan, you can't do work for the Government or the city or the State of Louisiana and sometimes for the Public Service without furnishing them with a bond.

Q. When you say that you have to have a bond, what are we talking about, Mr. Generes, what does that mean?

A. That means that if we don't do the work the bonding company will do it.

Q. Did you do a good bit of work for New Orleans Public Service as well?

A. We did quite a bit of work for them.

Q. And you say that on all of these jobs bonds were required?

A. Most of them.

Q. Did you do any private work as well as public work?

[36] A. No.

Q. Most of the—your work was in public works?

A. Most of it was public works.

Q. Mr. Generes, did you draw a salary while you were

performing—while you had this partnership formed with Mr. Kelly?

A. Yes, I did.

Q. What was that?

A. \$12,000 a year.

Q. Did you ever incorporate this partnership of Kelly-Generes Construction Company?

A. Oh, yes.

Q. When was that?

A. I think it was 1958, somewhere in there.

Q. 1958 or 1954, it may be a little earlier than that?

A. It could be either, Mr. Nathan, I don't know, I am getting at an age where my memory isn't too good.

Q. Mr. Generes, let me help you, I don't think the Government will object.

In 1958 the indemnity agreement was executed and it was in 1954 that Kelly-Generes Company was incorporated as such.

A. That could well be, but the record will show for itself.

Q. And do you recall why you and Bill Kelly incorporated [37] this company?

A. Here, to, for when I signed a bond, why I was liable for the bond and all the materials that we purchased, and I thought it would be a good idea for us to incorporate so I could limit my exposure and as to the ordinary creditors, although no creditor ever lost a dime from Kelly-Generes Construction Company or Kelly-Generes Company, they were all paid off in full, but I thought it was prudent to incorporate.

Q. To limit your personal liability?

A. Limit my personal liability, yes, sir.

Q. And do you recall the capitalization of the company?

A. Around \$100,000, that's my recollection.

Q. Well, Mr. Generes, let me ask you this, do you recall what percentage of the stock you owned in the corporation?

A. About 44%.

Q. How much did Bill Kelly own?

A. About 44%.

Q. You and he had about the same amount of stock?

A. About the same amount, yes, sir.

Q. And who else was in the corporation?

A. My son.

Q. What is your son's name?

A. Allen H., Jr.

Q. Allen H. Generes, Jr.?

[38] A. Right.

Q. What was your position in this corporation, what officer were you?

A. I was President of the company.

Q. Who was Vice-President?

A. Mr. William F. Kelly was the Executive Vice-President.

Q. Who was the Secretary?

A. Mr. Treuting.

Q. And who was the Treasurer?

A. We had no Treasurer.

Q. He was Secretary-Treasurer and served as one?

A. Yes, sir.

Q. Mr. Generes, when you said just a minute ago that the capitalization was about \$100,000, actually wasn't this the authorized capital?

A. That's right.

Q. What was the total amount you had actually invested in the corporation?

A. Individually?

Q. Yes.

A. About \$38,900.

Q. When you started in 1954, what did you do with the assets of the partnership of Kelly-Generes when you formed the corporation?

[39] A. The corporation bought them out.

Q. And this was your share of—that was your part of buying the stock in the corporation?

A. That's correct.

Q. And do you have any idea about what this was valued at in 1954?

A. Well, all told, Mr. Nathan, we had about \$650,000 worth of equipment when we liquidated.

Q. That's in 1962?

A. Yes, sir.

Q. In 1944 this was valued at about \$10,000?

A. Sir.

Q. In 1944 it was valued at about \$10,000?

MR. WINSTEAD: Your Honor, I object as leading.

MR. NATHAN: I think the record will actually show what the capitalization was, I was trying to help out to speed it along.

By MR. NATHAN:

Q. Mr. Generes do you recall the capitalization value you placed on the stock in 1954 when the corporation was first formed?

A. No, sir, I don't.

Q. Were you paid a salary as President of the corporation?

A. Yes, sir.

[40] Q. What was your salary?

A. \$12,000 a year.

Q. And what was—was Mr. Kelly paid a salary?

A. He was.

Q. What was his salary?

A. \$15,000.

Q. Was Mr. Treuting paid a salary?

A. He earned about \$8,000 a year.

Q. Did you receive this salary throughout the years 1954 until the liquidation of the company?

A. I did.

Q. It was the same salary every year?

A. Yes, sir.

Q. Were any dividends ever paid on the stock of Kelly-Generes Construction Company?

A. Never.

Q. Was the stock in the company offered for sale to the general public?

A. No, sir, not that I know of and if it had been, I am sure I would have been acquainted with it.

Q. Was it ever for sale on the open market?

A. No, sir.

Q. And from 1954 forward, you say no dividends were paid?

A. There never was a dividend paid.

[41] Q. When you incorporated, Mr. Generes, was there any change in the duties that you performed in the partnership and when you became President of the corporation?

A. No, sir.

Q. What were your duties?

A. My duties were to see that they were properly financed and that they were properly bonded.

Q. And were you ever—

A. On many occasions when there was a big job coming up Mr. Kelly would come to my office and go over the plans and specifications and our bid price.

My experience in eight years in the construction business gave me a pretty good knowledge as to whether prices were right or wrong.

Q. So you were called on for consultation?

A. At least once or twice a week.

Q. Did you have any general supervision working in the company?

A. Did I have—

Q. —any general supervision work in the company?

A. I'd go out on a job occasionally, but I wasn't out there everyday.

Q. What did Mr. Kelly do?

A. He was there all the time.

Q. When you say that, what do you mean?

[42] A. He was the General Superintendent of the—well, he was the Executive Vice-President, which required his time on the jobs to see whether the jobs were being executed properly and giving advice to the Superintendents as to what they should do and what they should not do.

Q. Is this what we generally mean when we refer to the field man?

A. How is that, sir?

Q. Is this what we generally mean when we refer to the field man?

A. Yes, sir.

Q. Now, you said earlier that part of your job was obtaining the credit, the banking and suretyship credit, I believe, would you explain to the jury why that is important and what you did?

A. Well, the—without a bond, a bid bond to begin with, we couldn't bid on the job, so consequently I had to sign an application for bid bonds.

In addition to that, after—if we were awarded a job, I'd have to sign the bond to properly execute it and all bills were paid.

Q. Mr. Generes, throughout the years immediately following 1954 and prior to 1958, what was the procedure followed when the corporation wanted to bid on a job and you needed a bond?

[43] A. If I was in the office, I signed the application. If I was out of town, we wouldn't bid.

Q. Did this ever occur that you would be out of town?

A. Oh, on several occasions.

Q. And when you say you did not bid, you mean the corporation did not bid?

A. The corporation didn't bid.

The bonding company wouldn't bond us without endorsement.

Q. Now, the requirement of this endorsement developed then only after 1954; is that right, after you incorporated?

A. No, I had to sign the bid bonds on all jobs.

Q. I am sorry, I think I may—

You may have misunderstood me, Mr. Generes, after the company was incorporated in 1954, it was at this point that the bonding companies required that you sign an indemnity agreement; is that right?

A. That's right.

Q. Prior to 1954, you, as partners, simply requested the bonds; is that right.

A. That's correct.

Q. And I think you just testified then that from 1954 on you signed an indemnity agreement individually for each job when you wanted a bond; is that right?

A. That's right.

[44] Q. What happened in 1958, Mr. Generes?

A. In 1958 we had a conference with a gentleman by the name of Mr. Cathcart, he is one of the Vice-Presidents of the Maryland Casualty Company, and we agreed to sign a blanket bond that would take care of all jobs.

In that case, it wouldn't be necessary for me to sign any applications for bonds, that blanket bond covered everything.

We had a line of credit from on the single job of a \$1,500,000, and on cumulative jobs of \$2,000,000.

Q. Without the bid bonds, you said before, without your indemnity agreement Maryland was not willing to give you these bonds?

A. They would not.

Q. And on occasion you were out of town, so you decided to execute a blanket indemnity; is that what you referred to?

A. That's right.

Q. Mr. Generes—

Let me show this to opposing counsel first.

MR. WINSTEAD: Yes.

By MR. NATHAN:

Q. I am going to show you a photostatic copy, I have marked on the front Generes Exhibit 1, and it consists of three pages, on the last page it has what appears to be [45] Kelly-Generes Construction Company, Inc., and Allen H. Generes and William F. Kelly signatures, would you look at this, Mr. Generes.

A. I have seen so many of these, I know them by heart.

That's my signature. I signed for Kelly-Generes Construction Company as President, and I signed as Allen H. Generes individually and beneath that, very faintly, I can see William F. Kelly, and that's his signature.

Q. This is a photostatic copy, but you recall that the original was signed and this is correct?

A. Yes, sir, otherwise we couldn't have been in business.

Q. Well, Mr. Generes, would you explain to the jury what you just meant when you said, "otherwise we would not be in business."?

A. Well, without a bond, ladies and gentlemen, we—no Government agency, city or the State of Louisiana would have issued us a contract.

We had to have a bond assuring them that the work would be properly executed, all bills paid.

Q. Why was it impossible to get those bonds, Mr. Generes?

A. Well, without my endorsement, it was no soap.

Q. Would you explain what you mean—what you mean by your saying, "it was no soap."?

[46] A. (Witness laughs.) Excuse me, Judge.

I meant by that there would be no job. I would have lost my job.

Q. Well, I think you have just testified that with the municipal work and many private works you have to have a bond and that you could not get the bond without your personal guarantee.

Who was it that—bonding companies that you dealt with, Mr. Generes?

A. Well, originally with Catheart, he lives in Baltimore.

He's the Executive Vice-President of the Maryland Casualty Company.

Subsequent to that, I dealt with Durel Black, a native of New Orleans.

Q. Did you do business with any other bonding companies, sir?

A. Yes, we did business with the USF&G, and with—we had a falling out, and I went over to Maryland.

Q. Is it not true that on every contract that Kelly-Generes Construction Company had that required bonds that they required your personal indemnity agreement?

A. Yes, sir.

Q. You said earlier that you would have lost your job, what do you mean by that, Mr. Generes?

A. I meant that I would have lost \$12,000 a year.

[47] Q. What would have happened to the business of Kelly-Generes Construction Company, Inc., if you had refused to sign these indemnity agreements?

A. They would have had to have gone out of business.

Q. Would you tell the Jury in your own words the nature of your dealings with Mr. Durel Black, you mentioned earlier that you had contacted him?

A. Well, Mr. Durel Black was the General Agent here for the Maryland Casualty Company, and he had the authority to sign bonds up to the extent of \$1,500,000 on a single job, \$2,000,000 on collective jobs, and I would always go over there and get him to sign them.

Q. And prior to the execution of this agreement marked Generes Exhibit 1, this blanket indemnity agreement, did you have to go see Mr. Durel Black each time you wanted a bond?

A. I'd either go there or he would bring the bond to me and I would sign it, and he would recognize my signature.

Q. You did, in fact, sign a bond for each contract?

A. That's right.

Q. And Mr. Black was the agent?

A. That's right.

Q. After 1958, when you signed this blanket agreement, how did the company do business with Maryland?

A. It wasn't necessary for me to sign anymore bonds, just go over there, ask for a bid bond, 5% or 10% of our bid, [48] and they would get the bid bond.

And if we were awarded the job, why they could execute the permanent bond.

Q. What kind of line of credit did they issue on the basis of a—this bond—that agreement, Mr. Generes?

A. \$1,500,000 on a single job, and \$2,000,000 on several jobs.

Q. With whom did you discuss that line of credit—let me ask you this first, Mr. Generes, what was the line of credit prior to that time?

A. Well, it was never established, Mr.—they never questioned us.

Q. All right.

So it was after this indemnity agreement that you had this very substantial line of credit?

A. That's right.

Q. All right.

Why did you want this line of credit, Mr. Generes, or why did the corporation want it?

A. Well, it facilitated matters and—

Will you repeat that question?

Q. What was the—how was the business doing in those years from 1954—

A. Very good.

Q. What was the—do you have any idea what the volume of business of the corporation was?

A. Well, from a million to two million dollars a year.

Q. And was it growing after 1954?

A. Growing right along.

Q. All told, between 1954 and the time the company liquidated, could you estimate approximately the total volume of business or jobs performed by the corporation?

A. About \$13,000,000.

Q. So in 1958 when you wanted to increase this line of credit, and you say you executed this blanket indemnity agreement, who were the persons with whom you dealt in deciding that this agreement would be executed?

A. Cathcart.

Q. What is his full name, Mr. Generes?

A. E. Kemp Cathcart.

Q. And who else, Mr. Black?

A. I don't think Black was in that conference.

Q. What requirements did Mr. Cathcart make when he spoke with you about this line of credit?

A. He wanted to see my financial statement, he wanted to see Bill Kelly's financial statement.

Bill showed him his. He glanced at it for a minute or two, and he passed it back to him.

He looked at mine and scrutinized it very thoroughly, and he says, "Well, Allen," he says, "I'll extend you a [50] line of credit of \$1,500,000 on a single job or \$2,000,000 on collective jobs."

Bill Kelly had a lot of equities, but he didn't have any quick cash.

Q. Could you explain to the Jury what you mean when you say he did not have any quick cash?

A. Well, I meant by that, when he saw my bank balance, how much money I was carrying in the bank, why—

Q. Mr. Kelly's assets were more in the nature of land; is that not right?

A. Sir?

Q. Mr. Kelly's equities were more in real estate, weren't they?

A. That's correct.

Q. Where you had cash on hand in Homestead stock?

A. That's correct.

Q. When we talk about quick assets, we mean assets that can be turned into cash?

A. Liquid.

Q. Did Mr. Cathcart tell you that at any time that Maryland Casualty Company would not issue bonds on Kelly-Generes without your indemnity?

A. Definitely.

Without my endorsement, there was no bond issued.

Q. After the execution of this agreement in 1958, Mr. [51] Generes, could you estimate for the Jury how many jobs Kelly-Generes performed after that before it went into liquidation?

A. So many that that would be a pretty hard—I could just guess—

Q. That's all right?

A. But—in how many years?

Q. After—after you executed this agreement, this blanket agreement—

A. Oh, that—

Q. —about how many jobs did Kelly-Generes perform?

A. I'd say about forty.

Q. Do you think it could have been more than that?

A. Forty, fifty or a hundred, I don't know.

Q. It was a very substantial amount of money?

A. Oh, yes, a substantial amount of money involved in it. We had quite a payroll.

Q. Approximately how many people did Kelly-Generes employ?

A. About 600.

Q. Mr. Generes, as a result of signing this blanket indemnity agreement which has been marked Exhibit 1, were you ever called upon to pay Maryland Casualty Company any money?

A. Yes, sir, I sure was.

Q. Would you explain to the Jury or tell the Jury in [52] your own words exactly what happened?

A. Well, when the

THE COURT: Would counsel approach the bench a moment.

(Conference between Court and counsel.)

By MR. NATHAN:

Q. Do you recall the question, Mr. Generes?

A. No, sir, I don't.

Q. You were about to tell the Jury in your own words what happened when you were called upon to pay Maryland Casualty Company pursuant to this

A. Oh, yes.

I was in the Baptist Hospital with a duodeno-ulcer hemorrhaging to beat the band and they came in and told me that—I thought I was at my death door—that Kelly-Generes was busted, and it upset me a whole lot.

As a matter of fact, Dr. Burnhart told me

THE COURT: Mr. Generes, I am going to have to interrupt you because this is irrelevant to the answer.

I know the Government and taxpayer have stipulated that as a result of the indemnity agreement that Mr. Generes has testified about, Mr. Generes was called upon and did pay a total of \$162,104.54—57¢.

By MR. NATHAN:

Q. Was Kelly-Generes Construction Company a closed [53] corporation?

A. Yes, sir.

Q. Were there any stockholders in that corporation other than you, William F. Kelly and the other persons who were the—who were the stockholders?

A. Well, I think it was myself, Kelly, I think his wife had a little part of Kelly's 44% and Lou Treuting, Philip Kelly and Allen H. Generes, Jr.

There were no strangers, all—it was a closed family corporation.

Q. Did you receive any return or any revenue from this corporation other than the salary of \$12,000 a year?

A. Only years where we made a lot of money, why they'd give us a—we'd declare a bonus.

Q. That was in the nature of a salary, was it not?

A. Well, you can call—I call it a bonus, it could be specified as a salary, I know I paid income tax on it.

MR. NATHAN: Your Honor, may I have just a moment. I have no further questions.

Mr. Generes, would you answer any questions Mr. Winstead has.

MR. WINSTEAD: Should I start before lunch hour?

THE COURT: Yes.

Would counsel approach the bench.

(Conference between Court and counsel at the bench.)
[54] Ladies and gentlemen of the Jury, I think we will pause at this time for our luncheon recess. I think it will take you a little while to get lunch at this hour.

We will try to resume at 1:15. I know that you may have some trouble getting lunch because of the crowded restaurants, but please try to get back so we can start promptly at 1:15.

I think if we can start promptly at 1:15, we can finish this afternoon.

Court will stand at recess until 1:15.

(Noon recess taken.)

THE COURT: Be seated, please.

Mr. Generes, would you come to the witness stand again, please.

CROSS EXAMINATION

By MR. WINSTEAD:

Q. Mr. Generes—

A. Just wait, Mr. Nathan has stepped out in the hall.

THE COURT: Excuse me, I didn't notice he left.

Thank you, Mr. Generes.

(Mr. Nathan enters the courtroom.)

MR. NATHAN: May I approach the bench, your Honor?

THE COURT: Yes.

(Conference between Court and counsel at the bench.)

THE COURT: Mr. Generes, it is called to my attention that you made an answer inadvertently with respect to the number of employees employed by Kelly-Generes; is that correct?

THE WITNESS: That's correct.

THE COURT: Would you tell us what number of employees the company did have, approximately?

THE WITNESS: I think I made the statement that we employed around 600 people, but during the recess, why I discussed the matter with some of my folks, and I found out that it run between 350 and 400.

By MR. WINSTEAD:

Q. Mr. Generes, Mr. Nathan had told me you had been under the weather the last couple of days, if you get tired, please let me know, just interrupt me at anytime.

A. Just go right ahead.

Q. Okay.

Mr. Generes, I believe you testified this morning before we went to lunch that the corporation was doing very well in 1958 through 1962; is that correct, sir?

A. Yes, sir.

Q. Mr. Generes, let me show you the corporate tax returns of the Kelly-Generes Construction Company, I don't know that you are too familiar with these figures and I am certainly not either, but let me show you what purports to be the corporate income tax returns for the Kelly-Generes [56] Construction Company for the fiscal year September 1, 1958, through August 31, 1959.

In other words, this is the—just take a look, if you would, please, sir, right here (indicating) this is a place on this return which asks you to take the taxable income from two prior years, which is 1956 and 1957, sir, and I'd ask you, sir, if you would tell the Jury what the income of Kelly-Generes Construction Company was in 1956?

MR. NATHAN: May I see this before—

THE COURT: Yes.

MR. NATHAN: Your Honor, may I ask for a moment to confer with the CPA on this?

THE COURT: Yes.

(Conference between counsel and the CPA.)

By MR. WINSTEAD:

Q. Mr. Generes, I know you are not too familiar with these tax returns, and I can understand why, but let me just state for your benefit, please, sir, to perhaps to refresh your memory:

Your return for the fiscal year ended August 31, 1959, shows that the prior year, the year ended August 31, 1958, the corporation suffered a loss of \$46,335.11, in the prior year they had a gain of \$17,951.00.

Now, Mr. Generes, there was no tax paid with respect to this corporate tax return for 1958, as you can see [57] here, tax due, none.

Mr. Generes, let me show you the corporate tax return for the fiscal year ended August 31, 1960—yes, sir, that's the year, this is the fiscal year we have here—there is another loss shown on this return of \$50,177.42.

Now, again no tax was paid with respect to the corporation's income tax return for that year.

Now, Mr. Generes, let me show you here (indicating) this is August 31, 1961, where there is a loss shown of \$36,000, and again no tax paid on that return.

And here is the return for the fiscal year ended August 31, 1962. Now, here (indicating) this return for the year—I am sorry, August 31, 1962 shows a net loss of \$563,541.

I think this return is beyond the years we are concerned with.

Now, Mr. Generes, I showed you the tax returns which indicate the corporation was, at least on its tax returns, doing less than all right during these years.

Now, would that be a fair statement that you were having financial trouble making a profit in the corporation?

A. Those returns are prepared by our CPA, and I have every reason in the world to believe that they are correct.

Q. Yes, sir.

I know the returns are correct, but I believe you [58] stated this morning that your present corporation was doing well. Now, the tax returns show in fact the corporation was suffering losses beginning in 1957 through this period here; do you recall those losses, sir?

A. No, sir, I do not; I was told we were going along all right.

Q. Mr. Generes, you testified this morning concerning the volume of business the corporation did, and I'd like to, on the return for the fiscal year ended August 31, 1959, I'd like to point out to you that the income for completed contracts by Kelly-Generes amounted to \$2,323,925.

Mr. Generes, I believe you also gave some testimony this morning concerning assets owned by this corporation, of which you own, I believe you said, 44% of the stock, on your returns for the fiscal year ended August 31, 1961, the corporation's balance sheet, which appears in the tax returns, shows at the end of that year assets valued at \$1,055,757; does that sound about correct as to the amount of assets owned by this corporation, generally?

A. Most of them was mortgaged.

Q. Well, these are the assets though, owned by the corporation?

A. Well, I couldn't answer that personally because I don't know.

MR. NATHAN: Your Honor, may I approach the bench [59] with Mr. Winstead?

THE COURT: (Conference between Court and counsel at the bench.)

MR. NATHAN: I want the record to show that counsel for the plaintiff objects to any cross-examination by the United States Attorney regarding these income tax returns where there are questions of the accounting principles.

Mr. Generes is not a Certified Public Accountant, and is not competent to testify as to the actual filling out of this return or possible aspects of it concerning depreciation and other bookkeeping entries which would be in the role of an accountant, and consequently, we object to any questions that may call for this knowledge on his part.

THE COURT: Objection overruled.

Let the objection be made general so it need not be re-urged.

MR. NATHAN: Okay.

By MR. WINSTEAD:

Q. Mr. Generes, you said the corporation was doing well, now, you don't know whether the corporation was making money or losing money in these years?

A. I was told that we were doing well. I assumed that we were.

Q. You personally didn't have any knowledge from your activities with the corporation as to how it was doing?

[60] A. No, sir, I didn't.

Q. I see.

Mr. Generes, I believe, just to touch basically, originally the Kelly-Generes Construction Company was a partnership, that was before the year 1954, when it was incorporated, and I think you testified that you went into a partnership with Bill Kelly; is that right?

A. That's right, sir.

Q. And Mr. Kelly is your son-in-law; is that right?

A. That is correct.

Q. Mr. Generes, were you the largest—didn't you have the largest interest in that partnership?

A. No, sir.

Q. You did not?

A. No, sir.

Q. Mr. Generes, do you recall your first deposition was taken, I believe it was August 26, 1965, a gentleman named Mr. McGuire was there and a Mr. Lynch from the Internal Revenue; do you recall that, sir?

A. Yes, sir.

Q. Let me, if I could, just briefly refresh your memory from your testimony at the time of that deposition.

The question, beginning on page 7, is as follows:

“Q. And the name was Kelly-Generes Construction Company?

[61] A. Inc., meaning corporation.

Q. I am talking about the partnership?

A. The partnership was Kelly-Generes Construction Company.

Q. Who were the partners at that time?"

Your answer was, "I was the major owner, or whatever you call it, I had the largest interest in it, in other words."

Now, sir, do you recall which of the testimony was given?

MR. NATHAN: Your Honor, may I object.

I think he should read the next two or three questions to make that complete; it's part of the same questions, same line of thought.

This may help the witness to remember.

By MR. WINSTEAD:

“Q. Who is the senior partner?

A. Senior partner?

Q. Bill Kelly?

A. Kelly was junior. My son-in-law, Jim Trudee and my son, Allen H. Jr. and Trudee.

Q. This was a general partnership?"

MR. NATHAN: And a Philip Kelly.

MR. WINSTEAD: I don't think I have that on my copy.

[62] MR. NATHAN: That was added because we did not waive the signing of the deposition and afterwards Philip Kelly was added.

By MR. WINSTEAD:

Q. Well, Mr. Generes, what I am concerned with here is whether you were the major owner of that original Kelly-Generes Construction Company before the incorporation?

A. It was a 50-50 proposition, I owned about 44% Mr. Kelly owned about 44% and the other minor stockholders owned the balance.

Q. I see.

A. I never—I never owned a major portion of the company. I was never a major stockholder.

Q. Let me ask you this, Mr. Generes, how did the other people, other than you and Mr. Kelly, obtain their interest in the partnership; do you recall that?

A. No, sir, I don't.

Q. Is it possible, Mr. Generes, you made a gift of the partnership interest to any of these people?

A. I beg your pardon?

Q. Do you recall whether you might have made a gift of the interest in the partnership.

MR. NATHAN: Your Honor, I am going to object to the question.

It is totally irrelevant and immaterial to this [63] lawsuit.

(Conference between Court and counsel at the bench.)

THE COURT: Let the record show the objection was sustained to the question as phrased.

By MR. WINSTEAD:

Q. Mr. Generes, let me ask you again if you recall, sir, what the capital investment was in the corporation when it was first incorporated in 1954?

A. I think we had an authorized capital of \$100,000.

Q. Do you recall, sir, how much of the capital stock had

been issued or how much money or equipment had been put into the corporation?

A. I—I know I had about \$38,900 in the corporation.

Q. And, Mr. Generes, let me ask you this, from this initial \$38,000 that you had invested in the corporation, did the amount of your investment increase over the years?

A. No, sir.

Q. It stayed exactly the same?

A. Same thing.

Q. And the corporation continued to grow and acquire assets?

A. I beg your pardon?

Q. The corporation continued to increase its volume of business; is that right?

A. That is correct.

[64] Q. Did the corporation continue to acquire substantial amounts of equipment to engage in construction?

A. Most of the equipment was bought on time, mortgaged, and the additional capital I supplied through bank credits.

Q. Let me get to that in just a minute, Mr. Generes.

First of all, let me ask you this, what was the dollar value of the equipment owned by Kelly-Generes Construction Company starting say in the year 1958; do you recall that?

A. No, sir, I can't answer that question, I don't recall.

Q. Well, was it—was it over \$500,000 worth of equipment?

A. Well, I think we had it appraised at \$650,000 but, of course, we had—most of this was all mortgaged.

Q. Getting to the mortgages, Mr. Generes, now, you said this equipment was often purchased under a mortgage situation whereby you had to guarantee loans from the bank; is that right?

A. Well, you'd buy the equipment right direct from the suppliers.

Q. But you borrowed the money to make the purchase from a bank?

A. Some times.

Q. Well, was this a fairly typical situation, you said [65] the equipment was mortgaged?

A. We had no trouble acquiring the capital to purchase the equipment.

Q. Well, were the loans made through the corporation itself, Mr. Generes?

A. With my endorsement.

Q. With your endorsement?

A. Yes, sir.

Q. In other words, you had to guarantee the payment for the corporation?

A. That's right.

Q. Let me ask you what motivated you to endorse or sign those notes on behalf of the corporation?

A. The corporation was paying me \$12,000 a year.

I had \$38,000 in it, and I figured in three years' time I would get my money out.

Q. You would get your money out, sir?

A. Well, I would be paid over the \$38,900. Three times twelve is thirty-six, I'd have a couple thousand in it and I wanted to keep that going.

Q. Did you guarantee these loans or negotiate loans so the company could acquire this to operate in the construction business?

A. At times I would.

Q. And during this same time, Mr. Generes, I believe [66] you testified this morning that you were President of Central Savings and Loan Association or Homestead; is that right?

A. I'm still the President, yes, sir.

Q. You were the initial founder of this?

A. I organized it.

Q. I see,

And you received during this year a salary of what, \$19,000 per year?

A. That's right—well, not when we first organized.

Q. Yes, sir.

A. When we first organized, I think I received a salary of around \$12,000, and then it was increased. As the business grew, my salary grew with it.

Q. But you were, at the time you went in with Mr. Bill Kelly in a partnership, you were at that time President of Central Savings and Loan; were you not?

A. That's right, sir.

Q. And during the years that we are talking about here,

1958 through 1962, you were receiving \$19,000 through those years?

A. I was.

Q. Let me ask you this, Mr. Generes, how much time did you devote to the activities of Central Savings and Loan Association during this time?

A. Whatever time was necessary.

[67] Q. Was it a full time job, Mr. Generes?

A. No, I wasn't tied down to a full-time job. I could go and come as I pleased.

MR. NATHAN: May we approach the bench?

THE COURT: Yes.

(Conference between Court and counsel at the bench.)

By MR. WINSTEAD:

Q. Mr. Generes, I think maybe you misunderstood my last question.

You testified that you were President and I believe General Manager of Central Savings and Loan Association during these years.

Now, what I want to know is how much time you devoted to your activities with Central Savings and Loan, not with Kelly-Generes?

A. I had to go to the office at 9 o'clock in the morning and I usually leave 3 or 3:30.

Q. Did you put in five days a week at the Central Savings and Loan?

A. Oh, yes.

Q. That's where your office was.

A. That's where my office was, that's where it is.

Q. Mr. Generes, let me ask you this, how much time did you spend per week dealing with the affairs of Kelly-Generes Construction Company?

[68] A. I spent as much time as necessary.

I got away from the office, my presence was needed at Central Savings and Loan, and I would go out on the job and discuss it with Mr. Kelly, and if it was necessary to stay out there three or four hours a day, I would.

Q. Let me, Mr. Generes, if we can get a little more specific, what would be your estimate of time per week you would spend with Kelly-Generes Construction Company's affairs?

A. Oh, I'd say probably six or eight hours.

Q. A week!

A. A week.

Q. Mr. Generes, do you recall when your deposition, another deposition was taken on April 29, 1966, by Mr. Bob White, I believe, of the Justice Department; do you recall that that was about a year later than your first one; do you recall that?

A. I recall Mr. White.

Q. Let me read to you, Mr. Generes, to again refresh your memory.

During the course of that deposition, page 20, Mr. White asked you:

"Q. Now, I take it from what you have said that the time you spent on the average week working during this period of time with Kelly-Generes Construction Company was very small?

[69] A. Yes.

Q. In the order or what per cent of your time?

A. It was necessary for me to walk over to the bank and borrow money.

We had a continuing bond and also had continuous credit over there.

Q. What do you think, maybe an hour a week?

A. May be.

Q. An hour a week?

A. Yes."

Now, Mr. Generes,

MR. NATHAN: Again, your Honor, let me ask for a complete reading, there is another question and answer.

MR. WINSTEAD: Well, I don't think it's relevant, your Honor, but I will continue reading it.

THE COURT: I haven't got it, so I can't tell whether it's relevant or not.

By MR. WINSTEAD:

Q. The next question is:

"Q. The rest of the time you spent right here working on Savings and Loan Association and loafing, you say.

A. And loafing, yes. Don't tell my boss."

A. Well, I was figuring I was kind of joking with Mr. [70] White.

Q. What I am concerned with, Mr. Generes, is whether

you worked about an hour a week on the affairs of Kelly-Generes Construction Company?

A. No, I devoted more time than an hour a week, that would be absurd, and was absurd on my part to state that I was putting in an hour a week.

You can't run a big business on an hour in a week's time.

Q. Mr. Generes, I believe you testified you received a salary of \$19,000 a year from Central Savings and Loan and you got \$12,000 a year from Kelly-Generes Construction Company.

I'd like to show you your tax returns now.

Mr. Generes, let me show you your return for the year 1959, which is a joint return, sir. Now right here (indicating) you report your gross income in this year, you and your wife of \$48,000; is that correct?

A. It must be if it is down there.

Q. You will vouch for the return?

A. Well, Mr. Guidry, my CPA, he made up the returns and they present them to me, and I take them for granted.

I want to say this to you that I have been paying taxes since 1961 and I never as much as dated one yet.

Q. Yes, sir.

A. I leave it up to them, they know more about it than [71] I know.

I know nothing about it.

Q. On these returns, the total for you and your wife on both returns is \$46,000 again, here (indicating), for 1960 you report income of \$23,000—excuse me, I got that wrong —no, that's right, 1961 is the next year.

You report income, gross income of \$31,000, and in 1962, \$26,000.

Mr. Generes, let me ask you what were your sources of income other than from the salary you received from Kelly-Generes Construction Company and Central Savings and Loan Association?

A. I have a filling station rented to the Humble Oil Company, that pays me \$5,000—\$6,000 a year.

I am a member of the American National Bank, they pay \$100 for a board meeting, I am on the board.

I am also on the executive committee and they pay \$100 for each meeting.

I have some stocks that I receive dividends on and that ought to make it up.

Q. The difference?

A. The difference, yes, sir.

MR. WINSTEAD: Your Honor, we would offer these as Defendant's Exhibits 1 through 5.

I have put in copies in lieu of the originals.

[72] MR. NATHAN: Your Honor, at this time may I also offer Generes Exhibit 1.

THE COURT: Yes.

Let both offerings be received.

By MR. WINSTEAD:

Q. Mr. Generes, in connection of the affairs of Kelly-Generes Construction Company, have you not also advanced substantial sums of money or loaned money to this corporation?

A. At times I have, yes.

Q. Mr. Generes, what was your reason for loaning money to the corporation, what necessitated that?

MR. NATHAN: I am going to—just a moment—object to that as being not a part of this lawsuit, and that again would be immaterial to this lawsuit.

THE COURT: Objection overruled.

By MR. WINSTEAD:

Q. Mr. Generes, let me ask you again, what occasioned or what motivated you to have to loan the money to this corporation?

A. If they had a job, if they had a rush, I'd lend the money to push it. That's about the—

Q. In other words, this money that you loaned the corporation was to enable it to do construction work and do business; is that right?

A. That's right.

[73] Q. I see.

Mr. Generes, do you know what the amount of the outstanding debt owed to you was when Kelly-Generes Construction Company went bad in 1962?

A. No, I don't remember exactly.

I know I had to pay the Maryland Casualty Company a hundred sixty odd thousand dollars.

I don't—I don't remember details, Mr.—

Q. Let me ask you this, Mr. Generes, were your reasons for loaning the corporation money any different from your reason for signing that indemnity agreement to operate?

A. Well, it probably could have had a job that they

needed some quick money on, and I'd lend it to them if I had it in the bank, and I always usually had to lend—

Q. What I am asking you is were your reasons for loaning the corporation money any different from your reasons for signing the indemnity agreement?

A. Well, I thought I was on a salary there of \$12,000 a year, and if I had a few thousand dollars and they needed it, I'd lend it to them. I didn't want to see them take on a job and not complete it.

I was on a substantial salary, and I thought it was my duty to do what I could to promote the company.

Q. Mr. Generes, did you not in fact loan money to the corporation and sign the indemnity agreement in order that the [74] company could operate and continue in the construction business?

Q. I wish you'd rephrase that, Mr.—

Q. Mr. Generes, is it not true that the reason that you—let me start over.

Mr. Generes, what I want to know is did you loan money to the corporation and sign the indemnity agreement, both, in order to enable the corporation to do business, operate in the construction business?

A. Well, I signed—I signed the indemnity bond because I knew—well, without an indemnity bond, the company couldn't operate, and if I loaned them any money, they must have needed it.

Q. They must have needed it?

A. Now, you know, that's years ago, and the older you get the less memory you have.

Q. Mr. Generes, I am going to show you now your income tax return for the year 1962 again, this is on the original, let me point out here (indicating), sir, that the total amount of your outstanding loans that went bad when Kelly-Generes Construction Company defaulted, could you read that figure, please, to the Jury?

MR. NATHAN: May I see it.

(Document to counsel.)

By MR. WINSTEAD:

[75] Q. Would you read this figure, please, Mr. Generes, to the Jury?

A. It looks as though it's \$158,814.49; is that right?

Q. Yes, sir, that's right.

Now, that's the amount of money that you had advanced to the corporation up to the time it defaulted.

Mr. Generes, let me ask you to also, on your tax return here, state the tax treatment accorded that amount, can you read that, sir?

A. No.

Q. Let me read it for you, sir:

"Non-business bad debt, notes receivable Kelly-Generes Construction Company," is that correct, sir?

A. You mean they owed me money?

Q. Yes, sir, they did and they never paid it, and on your tax return you treated it as a non-business bad debt, didn't you?

A. That's right.

Q. Mr. Generes, in connection with these loans did any corporate officer or employee threaten you with the loss of your job if you didn't loan the company money?

A. No one ever threatened me with losing my job.

Q. Now, what about signing the indemnity agreement, did Bill Kelly or any other person in the corporation ever threaten you with loss of your job or discontinuance of your [76] salary if you didn't sign the indemnity agreement?

A. No, sir, I signed voluntarily.

I knew without a bond Generes-Kelly couldn't operate, and I signed the bond with my free will and consent without anybody's influence.

Q. I see.

In other words, you say you signed the indemnity agreement, in other words, so that Kelly-Generes Construction Company could operate?

A. That's correct.

Q. Would it be a fair statement, Mr. Generes, that you could be the one to fire someone for not signing the indemnity agreement, you could fire yourself, could you not, sir?

A. I don't think it's customary.

Q. Mr. Generes, let me refer to your deposition again in connection with this.

This is the first one taken on August 26, 1965, page 25.

The question to you, Mr. Generes, was this:

"Q. I am interested in connection with your salary that you stated you received from the corporation.

You testified as to what your duties were, but you also testified that if you didn't sign these personal indemnity bonds then you would lose your job.

[77] Did you mean you would be fired by the company?

A. I meant the company would go out of business and there would be no company and, of course, if the company went out of business, I would have no job.

Q. It wasn't that you were told by any other partner or stockholders?

A. No, no, nobody could fire me."

A. Read me that again.

"Q. It wasn't that you were told by any other partner or stockholders?"

Your answer was:

"A. No, no, nobody could fire me.

I could fire myself, but they couldn't fire me.

If the company went out of business, naturally, I was out on a job.

Q. That is the reason you would cease to draw your salary, not that you would be fired for failing to sign bonds?"

Your answer was: "Oh, no, no."

Is that correct, sir?

A. Really I—I really don't understand it Mister, I am sorry, but I just don't understand the question at all.

[78] Q. Well, let me see if I can phrase it, Mr. Generes—

A. I am sorry to put you through so much trouble—

Q. That's all right, sir.

A. —but—

Q. And you testified here that you had to sign the blanket indemnity agreement in order that the company could operate; is that right, sir?

A. That's right.

Q. And no one forced you or told you you would be fired if you didn't sign it?

A. That is right.

Q. I believe you also stated you were interested in your salary because, if you did not sign the indemnity agreement, the Maryland Casualty Company wouldn't execute the bonds and Kelly-Generes Construction Company couldn't

get contracts and, therefore, would go out of business, and you would lose your job; is that right?

A. That is perfectly correct.

Q. Is that the relationship between your signing of the indemnity agreement and your job?

A. The reason I signed that indemnity agreement was to protect my job.

Q. Through protecting your investment, through protecting Kelly-Generes Construction Company?

A. The investment was very small, only \$38,000, and I [79] figured that if I signed this bond—I get \$12,000 a year, in three years' time I would be practically paid out of my investment.

Q. Mr. Generes, I believe you testified that the reason for signing the blanket indemnity agreement was in order that you would not have to sign individual agreements each time a bond was issued; is that correct, sir?

A. That is right.

Q. In other words, this was to enable this to be more convenient for you; is that right?

A. And to the company, too.

Q. In other words, if you were out of town they couldn't get a bond; is that right?

A. If I was out of town they couldn't get a bond, but when I signed this blanket bond, why they didn't have to come to me at all, they just go to the bonding company to get the bond, get the bid bonds.

Q. It sounds to me, Mr. Generes, that it was just a matter of convenience for you, that is the reason that the blanket indemnity agreement was signed, it was convenient to you and the company.

At the time you signed it, did you give consideration to the fact that you were protecting your job and salary at the time you signed it?

A. That's the reason I signed it.

[80] Q. To protect your job and salary?

A. That's the reason I signed it.

Q. Did you give any thought at all to your investment in the corporation?

A. No, I never once gave it a thought.

Q. Mr. Generes, let me ask you this, at the time you signed the blanket indemnity agreement, did you sign it

with the hope or expectation that Kelly-Generes Construction Company would succeed and thrive and pay dividends to you on your stock?

A. I never thought about dividends because we were growing, and I signed the indemnity bond for the purpose of protecting my salary, and that is what I had in mind.

Q. Mr. Generes, I hate to keep going back to your depositions, but I have no choice.

A. That's all right, sir.

Q. Let me refer you again to the second deposition that we took.

The question asked you, Mr. Generes, on page 30, was this:

“Q. In signing this blanket indemnity agreement, were you intending to try to keep the corporation operating?

A. Yes.

Q. To protect that investment you had?

[81] A. Yes, sir, to protect that and build up an estate for my children.

Q. Because they had a stock interest in the corporation also?

A. That is right.

Q. And I suppose the children directly or indirectly benefitted from the salaries from the corporation?

A. Sure.”

Again, Mr. Generes, going to page 33, the question asked you was this:

“Q. Well, I suppose that you viewed protecting your investment in this corporation as a significant purpose in signing the bond?

A. Yes, that is right.”

MR. NATHAN: Just a moment.

I am going to object again because the next question is extremely important.

MR. WINSTEAD: I will continue reading, your Honor.

“Q. Was that the most important purpose?”

A. Yes.

—“Was that the most important thing in your mind in signing the bond, sir?

A. No.

In my mind I thought we were doing fine, Mr. White.

[82] I was making money and I would get weekly reports here showing so much profit and in my opinion they were reports that I knew we had to have bond credit. Many times they wanted to bid on a job and I wasn't here to sign the application for a good bond and that job would go by the way; so then we decided to sign a blanket bond."

MR. NATHAN: Read the next question and answer.

By MR. WINSTEAD:

"Q. Now, isn't it a fact, though, that in signing this blanket bond that the principal purpose you had was to protect that \$50,000 investment you had in this corporation, to see that the corporation go bust and you lose your investment?

A. To tell you the truth about it, Mr. White, I never gave that a thought. I never gave my investment a thought. That \$1,000 a month I was getting and trying, as I said, to build up an estate for my children.

Q. —"

A. Mister, did I say that I had a \$50,000 investment?

Q. Yes, sir, I believe you did.

A. That was a mistake if I said it, my total investment was \$38,900.

Q. Mr. Generes, would it also be—you testified here [83] in your deposition that one reason you signed the blanket indemnity agreement was to keep the company going on behalf of your children who all worked for it?

A. That was partially true.

Q. Possible?

A. Possibly, yes.

MR. NATHAN: Mr. Generes, I ask you to speak louder, I believe the word you said was partially, not possible.

THE WITNESS: Partially.

Judge, can I ask the Jury if they can hear me?

THE COURT: I can hear you all right; I believe they can.

A JUROR: Yes.

THE COURT: The lady in the last seat says she can.

By MR. WINSTEAD:

Q. Mr. Generes, let me ask you this, in connection with your being asked to sign the indemnity agreement you said you had liquid cash, I believe you stated this morning,

what was your—were you in the habit of keeping large amounts of money in banks and so forth?

A. Yes, sir.

Q. What would be your average balance in the bank accounts during these periods?

A. I would imagine around \$30,000.

Q. \$30,000 in bank accounts?

[84] A. Yes, sir.

Q. Did you also own stock in the Central Savings and Loan?

A. One of the largest stockholders.

Q. What is the value of that stock, please, sir?

A. \$100 par value a share.

Q. Well, could you translate that into your stock ownership, Mr. Generes?

A. Between me and my wife?

Q. Yes, sir.

A. \$36,000.

Q. Mr. Generes, let me show you an exhibit which was attached to one of the depositions.

Mr. Generes, that is what Mr. Nathan marked Generes Exhibit 2 which is apparently a letter or memorandum of March 8, 1966, from Mr. Durel Black to Mr. Carroll, who, I believe, is with Maryland Casualty Company, and this concerns your individual financial statement at the time they were considering, I believe, raising the limit of the line of credit that you had through Maryland Casualty Company.

Would you please read this, sir, just the amount of cash in the bank as shown on—

A. Cash in the bank \$55,000, Central Savings and Loan Association \$30,000.

Q. I see.

[85] Now, that \$55,000 refers to your cash in the bank at that time; is that right?

A. That's right.

Q. Now, Mr. Generes in connection with these assets that we just talked about, your general statement that you had some times \$35,000 cash in the bank as well as I believe you said real estate and stock in Central Savings and Loan and \$19,000 salary from Central Savings and Loan; now, Mr. Generes, was the \$12,000 salary that you received from

Kelly-Generes Construction Company necessary for you to live on?

A. No, I could live on a lot less than that if I had to.

Q. I see.

And, Mr. —

A. And I have, too:

I started working at 25¢ an hour and supported a family, that was \$2.00 a day, so I could go back to it if I had to.

Q. I see.

But this \$12,000 was not necessary for you to live on during this period of time; is that right?

A. That's right.

Q. And if Kelly-Generes Construction Company went bad you still had your job with Central Savings and Loan and [86] still have it?

A. I still have it.

MR. WINSTEAD: I have no more questions, your Honor.

REDIRECT EXAMINATION

By MR. NATHAN:

Q. Mr. Generes, in the tax return for the year 1962, which Mr. Winstead showed you, marked D-5, on this last page when he—you quoted the non-business bad debt of money lent to Kelly-Generes Construction Company right above that is another entry for your stock ownership in Kelly-Generes Construction Company which has a value on it; can you read that value to the Jury?

A. Which is that?

Q. That's this one right here (indicating).

A. \$38,800.

Q. I think that is a nine, \$38,900.

A. \$38,900.

Q. Did that represent your full ownership of stock in the corporation?

A. That's right.

Q. Now, Mr. Generes, you answered questions about this last entry, the notes receivable of \$158,000, that was the year that — this was the year that Kelly-Generes went defunct; is that right?

[87] A. That's right.

Q. Was that an average amount that you lent to Kelly-Generes over the years?

A. No, I—I—as a matter of fact, Mr. Nathan, I borrowed

that money and gave the National American Bank the mortgage on some properties that I owned.

Q. Over the years, you testified that you did on occasion make loans to the corporation?

A. I did.

Q. In general, what was the amount of the loans that you made over those years, were they large or small?

A. Well, I wouldn't say they were large. I wouldn't say they were small.

They were medium size loans, maybe 15, 20, 25, \$30,000.

Q. And what would generally be the terms for repayment, the time limit?

A. There was no time limit on them.

Q. Now, were they generally re-paid?

A. Usually re-paid them within 60, 90, 120 days or six months.

Q. You testified under cross-examination that the general reason for making those loans was that the corporation needed, I think you said, quick assets; is that right?

A. That's right.

[88] Q. Would you explain to the Jury what you meant by quick assets?

A. Well, if the company had a job that had to be completed within a certain length of time, because on all jobs you have so many days or so many weeks to finish the job, if they had to finish them in a hurry, sometimes we'd have to employ night labor and double time, and that's one of the reasons why I would lend them the money so they could get it quick, wouldn't have to go through any rigmarole.

Of course, I could have gone to the bank and borrowed it, but I didn't do it.

Q. Mr. Generes, what is retainage?

A. Retainage, for instance, if you have a \$100 job, they will pay you up to 90% and then the 10% is retained for a certain number of days, I think it's 45 days foreman privilege, when that 45 days is up, why then you can go back and get your retainage.

Q. This means that the owner or state or municipality can retain some 10% of the funds due on a contract?

A. In New Orleans they retain it 45 days.

Q. So, in other words, the payments on a contract are made in stage payments, aren't they, Mr. Generes?

A. Stage payments.

Q. And there is a retainage where parts of the money is not due, is not paid until later?

[89] A. That's right.

Q. Now, you testified also, I believe that these returns for the corporation that were filed during these years were filed under what you called, I believe, a completed contract basis; is that right, or did you testify to that?

A. I don't recall that, Mr. Nathan.

Q. Mr. Generes, you answered one question for Mr. Winstead—

A. How's that, sir?

Q. You answered a question for Mr. Winstead stating that there was no superior in the corporation who could have actually fired you from your job, but—but that you were concerned about keeping the job.

Let me ask you this, in your deposition, as President of Kelly-Generes Construction Company, what would have happened to your job as President of the company if you had refused to sign indemnity agreements with the bonding companies?

A. We would never had been able to do any more work. We had to have that bond, and in order for us to get that bond, I am to indemnify the bonding company, otherwise it wouldn't have issued a bond to Generes-Kelly.

Q. What would have happened to your salary of \$12,000 a year if that would have happened?

A. Wiped out.

[90] MR. NATHAN: All right.

No further questions.

THE COURT: Any redirect, Mr. Winstead?

REBROSS-EXAMINATION

By MR. WINSTEAD:

Q. Mr. Generes, you said we could not pay, by "we" you mean Kelly-Generes Construction Company?

A. Kelly-Generes Construction Company.

Q. Let me ask you one other thing.

I believe you testified just a minute ago that you weren't concerned about—you didn't sign the indemnity agreement with the hope that you would get dividends; isn't that right?

MR. NATHAN: This is going beyond the scope—

THE COURT: He has a right to call him as an adverse party.

If you insist on the objection, I will have to sustain it and he will have to call him back.

By MR. WINSTEAD:

Q. Didn't you testify one of the reasons for signing the indemnity agreement was you weren't concerned about getting dividends on your stock?

A. Well, I hoped to get dividends eventually, but we never paid a dividend.

Q. But one reason for signing was the hope that you [91] would get dividends?

A. One reason I signed the indemnity agreement was to protect the \$12,000-a-year job.

Q. Mr. Generes, I am not asking you that, I am asking you if one of your reasons—one of them, not the only reason, the most important, I am asking you if one of your reasons was the hope that you would get dividends from the company?

A. Well, I hoped I would.

They were a long time coming. We never declared a dividend and our statements will show that we were not in a position to pay dividends at any time.

MR. WINSTEAD: I have no further questions, your Honor.

THE COURT: Thank you, Mr. Generes.

THE WITNESS: Sir?

THE COURT: You may step down.

Thank you.

The next witness, Mr. Nathan?

MR. NATHAN: Mr. Durel Black.

DUREL BLACK, called as a witness at the instance of the plaintiff, after being duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

By MR. NATHAN:

[92] Q. What is your name, Mr. Black?

A. Durel, D-u-r-e-l, Black.

Q. What is your occupation?

A. Retired.

Q. Well, during your business career what was your occupation?

A. Well, for forty odd years I was in the insurance and bonding business.

In the latter years, I was a managing and senior partner of the Black-Rogers Company.

I was General Agent for Maryland Casualty & Surety Company and became Vice-President of Maryland Casualty.

Q. Have you been associated with any professional societies in the surety business?

A: Yes, the local groups and at the national level, I was a member of the Board of Directors of the National Association of Casualty and Surety Agents.

And for two years after having been a lower-grade officer, I was President of the National Association of Surety Bond Producers.

Q. What is the business of Black-Rogers, what is the nature of the business they were in or were in at the time?

A. General insurance and bonding.

Q. Did they handle the writing of bonds for Kelly-Generes Construction Company?

[93] A. For a good many years.

Q. Did you personally handle any of that account?

A. I did.

Q. Were you familiar with that account?

A. Closely supervised it and handled most of the details.

Q. When did you first begin to handle the Kelly-Generes account?

A. It was first handled in the Black-Rogers combination by my former partner, Clarence Rogers.

He died about 1949, and from there on it was under my supervision.

Q. That was approximately what date?

A. 1949.

Q. Kelly-Generes was a partnership at that time; is that correct?

A. In the first stages it was William F. Kelly Company, but it was the same operation.

Q. William F. Kelly Company was back even in the early forties?

A. That's correct.

Q. And when it became Kelly—did you handle it even when it was William F. Kelly Company?

A. Not personally, it was handled in the office, but not under my immediate supervision.

[94] Q. What was the nature of the work Kelly-Generes

Construction Company performed that required your services?

A. The supervision of the writing of general insurance, as required on their operations, but mainly the bonding of accounts which they did in all phases of work for private owners, municipal, federal, state and governmental.

Q. Did they handle a very large municipal construction business.

A. I would say yes.

Q. And bonds were also required on those?

A. Bonds were required on all of that, there may have been a few of the private jobs that didn't require it, but that was only a small part of the operation.

Q. Did you handle this account even after Kelly-Generes Construction Company became incorporated?

A. I did.

Q. Now, prior to the time it incorporated in 1954, did you require indemnity agreements from Allen Generes or Bill Kelly?

A. It was automatic.

As partners under the Louisiana law, they were automatically responsible for the entire operation.

Q. Well, after they incorporated in 1954, what underwriting requirements were made with regard to the bonds?

A. Well, when their work reached the million dollar [95] stage, which it reached shortly after we required the personal indemnity of Bill Kelly and Allen Generes.

Q. And immediately after the incorporation, let's say from 1954 to sometime in 1958, how was this handled, were bonds required?

A. In the early stages they signed each—each application by the operation became so comprehensive, we issued—we had them execute a blanket indemnity agreement which was continuing in form.

Q. In general, what are the requirements that the bonding company looks for in writing a bond for a contractor?

A. The standard surety procedure, which is generally followed by most of the companies, is that the contractor must have adequate experience in the phases of work which he is going to undertake, which is to be covered under the bonds to be written.

He must have adequate equipment.

Adequate organization, and in general speaking terms, approximately 10% quick assets to the total line.

Q. And in your connection with Black-Rogers and Maryland Casualty Company, did you have occasion to study the account of Kelly-Generes Construction Company?

A. I did.

Q. And how did you find them with regard to those tests?

[96] A. With the combination of the resources which were—with the individual resources, it was entirely adequate.

Q. Why was the personal indemnity of Allen Generes required?

A. Well, Allen Generes had been a pioneer in the construction business for the—for many years, and he had the know-how and he was always one who was consulted on financial matters concerning the firm's operations.

Q. Mr. Black, let me show you Exhibit Generes 2.

Mr. Black, this is a letter which is marked Generes Exhibit 2 and which purports to bear the name Black-Rogers and Company, and your name Durel Black, can you identify that letter?

A. It was a letter dictated by me on the date of March 8, 1956, signatures—the initials at the bottom identifying my signature and H.K., those are the initials of Mrs. Helen King whom—who was my secretary.

Q. To whom did you write the letter, Mr. Black?

A. To Maryland Casualty Company, Contract Bond Department.

Q. To whom is it addressed?

A. It is addressed to the Contract Bond Department, C.W. Rasin, Jr., who at the time was the Supervisor in the Contract Bond Department of the geographical area in which Louisiana is included.

[97] Q. What was the purpose for writing this letter—let me ask you this first.

It says Dear Carroll—

A. That is his first name.

Q. Mr. Rasin?

A. Yes.

Q. What was the purpose of writing this letter?

A. The purpose for writing this letter was to confirm a

verbal agreement reached by Vice-President Cathcart for the line of bonding credit to be set at a million dollars.

Q. What is the date of this letter?

A. March 8, 1956.

Q. That's about two years before the continuing indemnity agreement was executed; is that correct?

A. That's correct.

Q. Now, what does the second paragraph of this letter state, would you read this second paragraph to the jury?

A. "I showed the original statement to Mr. Cathcart and Mr. Keyes at the hotel, and based upon the execution of bonds on behalf of the corporation, with the indemnity of Mr. Generes and Mr. Kelly, we have agreed upon a million dollar line."

Q. And as a result of this letter, the indemnity agreement which was referred to in there, what did Maryland—what action did Maryland Casualty Company take?

[98] A. They confirmed the million dollars' credit for the bonding of the contracts.

Q. What does that mean, he had a million-dollar-credit line?

A. Well, that would mean that in the—in the contract size that the total of uncompleted work would be bondable up to an aggregate limit of one million dollars.

Q. Provided you had the indemnity agreement of Allen H. Generes; is that right?

A. That's correct.

Q. Was that line ever increased beyond a million dollars?

A. The line was increased approximately, I would say, two years later to a two million dollar total, and it specified when the increase was made that the individual contracts would be set at a million one—at a million and a half.

Q. Were very many contracts signed in the period from 1954 to 1958, sir, for which bonds were needed?

A. It would be difficult for me to say exactly from memory.

I would say in excess of maybe fifty or a hundred.

Q. And prior to the execution of the continuing indemnity agreement in 1958, what procedure did you follow on each occasion when Kelly-Generes needed a bond?

[99] A. We required them to be—

MR. WINSTEAD: Your Honor, I think a lot of this is getting accumulative.

We heard a lot of this before on the procedures, about the straight indemnity before the signing of the blanket indemnity agreement.

THE COURT: Would counsel approach the bench, please.
(Conference between Court and counsel at the bench.)

By MR. NATHAN:

Q. Mr. Black, you know of your own knowledge, personal knowledge, that the blanket indemnity agreement was executed in 1958?

A. I do.

Q. And as a result of that blanket indemnity agreement, were bonds issued by Maryland Casualty Company for Kelly-Generes Construction Company?

A. That's correct.

Q. Was it a firm requirement of Maryland Casualty Company that they not issue bonds to Kelly-Generes without the personal indemnity of Allen H. Generes?

A. That was a rule set up by the home office.

Q. If Mr. Generes had refused to sign a personal indemnity agreement, what would have happened with respect to bonds issued by the company for Kelly-Generes?

[100]. A. They would have been declined.

MR. NATHAN: I have no further questions.

CROSS-EXAMINATION

By MR. WINSTEAD:

Q. Just briefly, Mr. Black, let me ask you this, Mr. Generes told us this morning that Kelly-Generes Construction Company had several hundred employees; why were these two particular employees singled out to sign the indemnity agreements?

A. Because they were the dominant operators of the business.

Q. Dominant stockholders in the corporation, right?

A. As I recall it, they each had something like forty odd per cent.

I don't—I don't have the exact figures.

Q. Let me ask you this, Mr. Black, is the fact that this was a family-held corporation essentially, is that an important factor you considered in your decision to issue bonds?

A. No, I wouldn't think the relationship of family would have any value at all on it.

Q. It has no relation as to who you were looking to for performance on bonds or indemnity agreements?

A. No, the indemnity agreements are by the person who actually signs the agreement, and we will look to those who [101] have resources to add strength to over-all structure.

Q. Let me ask you this, in your business, Mr. Black, assume you have a family corporation where I am the father and I own 80% of the stock in the family corporation but I am not employed by it at all, my three sons are; who do you look to for an indemnity in a situation like that?

A. It wouldn't make any difference who it was, just so the person who was going to be the indemnitor had the resources and backing which would be in back of the corporation.

Q. Who do you think in a situation you would look to—

MR. NATHAN: Your Honor, I object to any other questions on a hypothetical situation like that, I don't think it's fair to ask the witness questions such as that.

He should ask him specific questions about the circumstances here.

THE COURT: Objection sustained to the question as put.

By Mr. WINSTEAD:

Q. Mr. Black, let me refer you to your deposition, I believe, which was taken August 26, 1956; do you recall that, sir?

A. I do.

Q. This is the question asked to you by Mr. Nathan—

[102] MR. NATHAN: What page?

MR. WINSTEAD: Excuse me, page 56.

By Mr. WINSTEAD:

"Q. Mr. Black, on the basis of your experience, in instances where a personal indemnity is required, and we are now talking about in terms of the corporation rather than an unincorporated association, would the fact that a corporation is not publicly held but it is a closed corporation which is not listed on a stock exchange, as opposed to a corporation which is publicly held and is either sold in the over-the-counter market or listed on one of the major exchanges, would that fact that this was a closed corporation and not publicly held, have any bearing on whether you might require an indemnity agreement?

A. I wouldn't say it would have the specific—it would not be the basis of a specific decision, but the overall consideration of it would be important.

Q. Do you think it would be an important factor to consider?"

Your answer was: "Yes."

"Q. —Along with the equipment, the business experience, and these other factors—

A. Yes.

Q. —that you mentioned?

[103] A. Yes, because in the case of a closely held corporation, the principal stockholders are the ones who are going to gain, and if they don't have confidence in their own corporation it would lessen the confidence of a surety company.

Q. It would be of concern that the assets might be in it one day and out another day and you would be left with nothing but a corporate shell?

Is that a fair statement, Mr. Black, that you would look to the principal stockholders in a closely held family corporation for an indemnity agreement?

A. Not necessarily.

They could get outside indemnitors to come in and serve the purpose.

Q. Is it likely?

A. Usually a person who is going to sign an indemnity agreement, sir, would be doing it for a gainful purpose.

Q. Let me ask you this, Mr. Black, in connection with that, I believe, you stated—in that agreement the considerations stated for Mr. Generes and Mr. Kelly signing that blanket indemnity agreement is \$1.00.

Now, how do you justify asking men like Mr. Generes and Mr. Kelly to sign that agreement for the consideration of \$1.00?

[104] MR. NATHAN: I am going to object.

Before we can ask a question like that, we have to see what this agreement says.

Counsel well knows this is an agreement drawn under Common Law where many times for \$1.00 and other good and valuable considerations, this is not fair to ask a witness—a witness living in the State of Louisiana under Civil Law about an agreement drawn under Common Law.

THE COURT: The question is not directed to the law applicable.

MR. NATHAN: I think it is very misleading.

THE COURT: It may be misleading, but I will permit him to answer.

MR. NATHAN: Can we say if the consideration—where it says that, I don't think it is fair without letting the witness see the agreement.

By MR. WINSTEAD:

Q. I don't know if I can read this, it's kind of faded out:

"Now, therefore, in consideration of the premises and the sum of One Dollar (\$1.00) this day paid by the company to each of the indemnitors, receipt of which is hereby acknowledged, and in further consideration of the execution and delivery, from time to time, by the Surety of any such instrument or instruments, the said Indemnitors hereby bind themselves, their heirs, executors, administrators, successors and assigns, jointly, and severally!"

Now, Mr. Black, did any consideration change hands at the time this agreement was signed, was this dollar changed hands?

A. I don't recall.

Q. You don't recall.

A. But, sir, that form was not especially drawn for the Kelly-Generes Construction Company, this is an approved form of the Surety Association of America and is the same for that's used by surety companies throughout the country, so I don't think we would be able to say it was drawn especially for this.

Q. I am not trying to imply that, but in connection with what Mr. Nathan said, do you know what good and valuable considerations or any moneys or anything of that sort—

A. I would say yes, Allen Generes had a first-class salary.

He was paid by the Kelly-Generes Construction Company, and he was certainly interested in making the company a successful company so he would continue to derive that salary.

Q. Do you think he might have also been interested in [106] his stock ownership in that company and the amount of money he had invested in it?

A. I think he certainly would be interested in that, but I think his ratio of salary was more important.

Q. You don't know what Mr. Generes' motivation was?

A. What his what?

Q. I will withdraw the question.

Mr. Black, let me ask you this, in 1958 when the blanket indemnity agreement was signed, what was Kelly-Generes Construction Company worth at that time?

A. I would have to refer to the financial statement to give you a true answer.

Q. Would one million dollars sound right to you?

A. No, it would be too high.

MR. WINSTEAD: I have no further questions.

THE COURT: Anything further of Mr. Black, Mr. Nathan?

MR. NATHAN: Nothing further.

THE COURT: Thank you, Mr. Black.

Who is your next witness, Mr. Nathan?

MR. NATHAN: Your Honor, for the next witness, I propose to read the deposition of Mr. Cathcart into the record.

THE COURT: Ladies and gentlemen, the next witness is not able to be here in Court today, so his deposition was [107] taken under oath and transcribed by a Court Reporter.

His deposition will be read at this time. You are to give this deposition exactly the same credit as you would if the witness were here in person testifying, neither more or less, exactly the same as if he was here on the witness stand.

Of course, the person reading from it is not the person who gave it. It will be read by an assistant of Mr. Nathan, who will simply take the role of the witness.

By MR. NATHAN:

"E. KEMP CATHCART, 1723 East 33rd Street, Baltimore, Maryland, after being sworn as a witness in this cause, testified as follows:

EXAMINATION BY MR. NATHAN

Q. State your name, please.

A. E. Kemp Cathcart.

Q: K-e-m-p?

A. Yes, sir. ~

Q. What is your age, Mr. Cathcart?

A. Seventy-one.

Q. What is your occupation?

A. Retired.

Q. What was your occupation, before you retired?

A. I was Vice-President of the Maryland Casualty Company, in charge of the fidelity and surety operations.

[108] Q. How long did you occupy that position?

A. Since 1944, until I retired in 1960, April, 1960.

Q. Do you have any other, professional qualifications in this field?

A. Well, I am a lawyer. I am a member of the Maryland Bar and Ohio Bar. I practiced in Maryland a little, but more extensively in Cleveland, Ohio, I was Chairman of the, I think it is the Surety Advisory Committee of the Association of Casualty and Surety Companies, and I have been Chairman of the Executive Committee of the Surety Association of America.

Q. Mr. Cathcart, in connection with your position as Vice-President of the Maryland Casualty Company in the Fidelity and Surety Division, what was the nature of your duties?

A. Principally underwriting of fidelity and surety bonds.

Q. In that connection, what was your authority as such? Were you the person authorized—

A. I had unlimited authority in authorizing execution of those bonds.

Q. Would you actually handle the execution of the bonds?

A. Well, I wouldn't handle the actual physical detail. I would authorize our attorney in fact to execute.

[109] Q. In other words, if a local agent wanted Maryland to bond a given company and the amount required was in excess of the local agent's authority, you would be the person at the top of the ladder with authority to approve Maryland's entering into that venture?

A. That is correct, yes.

Q. Did you have many people operating under you?

A. Well, I would say at times it varied. I would say up to one hundred.

Q. And these people might have various limitations to their authority?

A. Oh, yes, but they would be in different departments such as the Contract Bond Department, the Public Official Department, the Fiduciary Department, the Fidelity Department, the various Blanket Bond Departments, and so on, the Forgery Department and so on.

Q. Would that also be divided on a geographic basis?

A. Well, as an illustration, the Contract Bond Department would have a manager and under that manager would be underwriters, and the country as a whole would be divided among those underwriters. One man would have a

certain section, another man would have a certain section, and so forth.

Q. Do you know who a man by the name of Carroll Rasin is?

A. Carroll is the Contract Bond Underwriter covering [110] this territory, the Louisiana territory.

(There was a discussion off the record.)

Q. Mr. Rasin would have the New Orleans territory, whereas your territory as such would be the entire nation?

A. That's right, the entire country, yes, wherever they wrote bonds, whether out of the country or in the country, it covered everything.

Q. In your position, and on the basis of your experience, are you familiar with bonds which are variously called payment bonds and others called performance bonds?

A. Yes.

Q. Would you state what a payment bond is?

A. Essentially a payment bond guarantees the payment of the labor and material bills incurred on an improvement, and the performance bond guarantees the performance of the contractor for the completed improvement.

Q. So that the purpose of these bonds is to see that the job is completed and turned over to the owner free of all liens?

A. That's correct.

Q. And encumbrances?

A. Correct.

Q. When are they generally required?

A. Well, publicly, they are required almost all of the time and publicly whenever the person making the improvement [111] thinks it necessary for economy purposes to require a bond, which is not infrequent.

Q. What would be an example you can think of?

A. Oh, on improvements?

Q. Private citizens?

A. Well—

Q. Would mortgages be likely to require it?

A. Yes. That is not uncommon. There was a class of bonds called the Mortgage Guarantee Bond but they went out of existence when almost all of the companies went broke that attempted to write them.

Q. Would you say that these bonds we are talking about

were required on all public works, and by this we generally refer to federal, state, municipal, county or parish, and the other public improvements?

A. That is, those bodies generally require bonds or almost always require bonds. There are exceptions, depending. I think on some small contracts the various departments have the power to do some work without bonding, but generally the bond is required.

Q. In your capacity as an officer of the Maryland Casualty Company, did you have occasion to become familiar with the Kelly-Generes Construction Company account?

A. Yes, I knew the account.

Q. Were you familiar with it before it became incorporated [112] prior to December, 1954?

A. Yes, I was familiar with the account.

Q. Both before and after incorporation?

A. That's correct.

Q. Did this company ever request that Maryland execute bonds on bid bonds or bonds covering jobs that the company had?

A. Oh, frequently.

Q. Were these bonds issued?

A. Yes, I think they were always issued subject to the basis of our underwriting requirement."

THE COURT: Would counsel approach the bench, please?

(Conference between Court and counsel at the bench.)

THE COURT: Ladies and gentlemen, a good deal of the remainder of this deposition is in essence a duplicate of what Mr. Black has already testified, therefore, the plaintiff and the defendant have agreed that if the remainder of the deposition were read aloud to you Mr. Black has already testified to you.

In other words, Mr. Cathcart would say substantially the same thing, perhaps in slightly different words, that Mr. Black has already said.

Does the plaintiff so stipulate?

[113] MR. NATHAN: Yes.

THE COURT: Does the Government so stipulate?

MR. WINSTEAD: We so stipulate, your Honor.

THE COURT: Mr. Nathan, who is your next witness?

MR. NATHAN: I would like to call as our last witness Mr. William F. Kelly.

THE COURT: Ladies and gentlemen, would you like to stand up and stretch, we will give you a little seventh inning stretch.

I don't want to call a recess at this time.

MR. NATHAN: Your Honor, before we proceed, it appears that I have not introduced Generes Exhibit 2.

I want to offer it.

THE COURT: Any objection?

MR. WINSTEAD: No objection.

THE COURT: Let the offering be received.

WILLIAM F. KELLY, called as a witness at the instance of the plaintiff, after being duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

By MR. NATHAN:

Q. What is your full name, Mr. Kelly?

A. William F. Kelly.

Q. Where do you reside?

A. I reside at 100 Bellaire Drive in New Orleans.

[114] Q. What is your occupation?

A. I am a Developer-Contractor.

Presently, I am developing Avondale Homes, low-cost, medium houses.

Q. What are some of the corporations in which you are involved?

A. At the moment, I am connected with Elbilco, Kelven, Kelly Systems, Elbilco and d/b/a Elbilco Service Samco.

Q. Which of these corporations developed—

A. Kelven, Inc. is the land developer.

Elbilco, Inc. is the housing developer.

Q. Do you personally do a good deal of work in the development?

A. I head up all those corporations and spend most of my time in their activities.

Q. Mr. Kelly, are you married?

A. Yes, I am.

Q. What is your wife's name?

A. Eloise Generes Kelly, she is the daughter of Mr. Generes.

It is my good fortune to have him as my father-in-law.

Q. You are the son-in-law of Allen H. Generes, the plaintiff in this lawsuit?

A. Yes, I am.

[115] Q. You testified a moment ago you are very substantially involved in the development of Avondale Homes in the construction business?

A. Yes, it is in all phases of it, from land development, drainage, pumping stations, sewerage disposal.

As a matter of fact, our sewerage disposal plant was just recently brought into a major development on the parish's request for the area.

Q. How long have you been in the construction business, Mr. Kelly?

A. Ever since my youth.

When I was a very young boy, I started as a waterboy on a paving crew.

Q. Approximately when was that?

A. Early '30, '31, '32, no later than that.

I did all sorts of Mississippi River levees, highways in the early stages in the '30's.

One rather unusual occupation was with Horace Williams, we put the first off-shore drilling platform in the Gulf of Mexico for Superior Oil off the Louisiana coast.

Q. Have you done work for others as a contractor?

A. Yes, I did.

As a matter of fact, it's somewhat humorous, I worked as a safety engineer on the WPA.

[116] They fired me for doing something I thought wasn't at all unsafe.

I figured I'd better go into business myself if I was subject to those kind of whims.

So I did.

Q. When was that, Mr. Kelly?

A. Oh, that was about 1936, '37, '38, thereabout.

Q. Did you subsequently go into business with Allen H. Generes?

A. Yes, I did.

Shortly after World War II—correction the defense of World War II began—I started to get more work than I could handle, and I did not have the business background experience or the resources to do the things I wanted to do, so Mr. Generes and I associated in a partnership.

He provided the business experience, financing, bonding capabilities, and I tried to get the work and get it done.

It was a good team.

Q. This was beginning together in early 1940's?

A. Yes, sir.

Q. And did you operate as a partnership during those years?

A. Yes, we did.

Q. What was the name of the partnership?

[117] A. It started off as William F. Kelly Company, and then it went to Kelly-Generes Construction Company.

Then, we converted to a corporation in 1954, so as to limit our obligations to the corporate creditors.

Q. Mr. Kelly, what was the nature of the work performed by Kelly-Generes Construction Company?

A. We did just about all types of heavy construction from bridges—

MR. WINSTEAD: Your Honor, I am going to object again.

I think this is cumulative. We heard a thorough discussion of what Kelly-Generes did, I think everyone knows now.

By MR. NATHAN:

Q. Mr. Kelly, it is apparent that everyone knows, so let's move on to another question.

In connection with your work with Kelly-Generes Construction Company, did the company have occasion to need bonds for its contracts?

A. Without them we couldn't have operated.

Only on the smallest little private work could you operate without a bond.

All federal, state, parish, city, most large corporate work had to be bonded.

Q. And who in the corporation obtained these bonds [118] for the corporation?

A. That was Mr. Generes' obligation.

Q. Was he an officer of the corporation?

A. He was President.

Q. What were you?

A. I was Executive Vice-President.

Q. How much did Mr. Generes get paid to be President of the corporate operation?

A. \$12,000 a year.

Q. What was your salary?

A. \$15,000 a year.

Q. Approximately how much time did you spend on the job as Vice-President of the corporation?

A. The bulk of my time was spent either on the job or in the office making estimates, or in supervision, 90% of my time was spent with the construction operations.

Q. What about Mr. Generes?

A. Mr. Generes would spend whatever time would be necessary, sometimes it would be an hour a week, sometimes it would be two or three days a week. It depended on the particular problem that I would go and talk to him about at the time.

Q. What would he generally do as President in rendering services to the corporation?

A. Well, oh—when we get ready to build—bid a [119] major job, I'd go discuss it with him and attempt to draw on some of his background, because you never know when an idea will come up after you have prepared the bids.

I would discuss the various facets of it with him, talk to him about getting the necessary checking to be sure we had adequate checking arranged and bonding.

Q. What was his primary duty as President?

A. His primary duty as President was to secure adequate credit and financing for operations and to secure bonds, without which we just simply couldn't operate.

Q. And how did he do this?

A. He secured the bank loans by use of his credit.

He'd secure bonds by endorsement, indemnities to the bonding companies.

Q. Did you also agree to indemnify the bonding companies?

A. Yes, I did.

Q. How did your financial statement compare—in the year 1958, did you also sign a continuing indemnity agreement?

A. Yes, I did.

Q. Between 1954 and 1958, did you regularly sign the indemnity agreements on each job when a bond was needed?

A. No, that was done almost exclusively at that time by Mr. Generes.

[120] Q. In 1958, did you sign the continuing indemnity agreement along with Mr. Generes?

A. I signed a separate one, but I did sign one at that time.

Q. And this was a continuing agreement which said—this would pay for all—

A. I didn't have any real financial monetary assets, they were invested, but since I was responsible for the operation of the jobs, the bidding of the jobs and the administration of them after we got them, they wanted to be sure I had a sincere interest in being right for what it was worth.

Q. How did your financial statement compare with Mr. Generes'?

A. Hardly anything by comparison.

Q. Prior to 1958, at the time you signed this blanket indemnity agreement, was there ever any problem about losing jobs because Mr. Generes was not available?

A. Yeah, when you need a bid bond or something like that, you have to bid a job, you just can't ask for it and get it without the proper procedures and if he wasn't available, off on a trip or couldn't get him, we just couldn't bid the job.

It was just that simple.

Q. Mr. Kelly, do you have any idea as to the volume of [121] business that Kelly-Generes Construction Company did over this period from 1954 to the time it went under in 1962?

A. I would say from my memory and recent checking, it was in excess of \$14,000,000.

Q. Very substantial, was it not?

A. Oh, no doubt about that.

Q. Did the corporation ever pay any dividends during that period?

A. Never did.

Q. How much stock did you own in the corporation; do you recall?

A. I had about 40—45.3 per cent or thereabouts.

Q. Approximately 45?

A. Yes.

Q: Was your interest the same as Mr. Allen H. Generes'?

A. Yes, it was identical.

Q. Was the stock in Kelly-Generes Construction Company available to the general public?

A. No, it was a closed corporation, privately held, it wasn't available to anybody but the few of us that had it at the time.

Q. There was no regularly quoted price of this stock on the open markets?

A. No.

Q. Did you ever offer stock for sale to anyone?
[122] A. Of course not.

Q. Mr. Kelly, if Allen H. Generes had refused to sign continuing—an indemnity agreement agreeing to indemnify the bonding companies, what would have happened to Kelly-Generes Construction Company?

A. No bonds, we would have just gone out of business.

Q. If that would have happened, what would have happened to his job as President of the company?

A. He wouldn't have it.

MR. WINSTEAD: This is pure conjecture.

THE COURT: The question has been answered.

THE WITNESS: Without the bonds—

THE COURT: That's all right, don't go any further, Mr. Kelly, you have answered the question, don't go any further.

MR. NATHAN: I have no further questions.

CROSS-EXAMINATION

By MR. WINSTEAD:

Q. Mr. Kelly, just briefly you stated that you had no intention of selling any of your stock in the company.

Do you have any idea what the fair market value of this stock was, did you ever find out about that?

A. I don't think it had a market value per se.

I didn't know of any.

We never attached any dollar and cents value on it [123] per share other than bookkeeping.

Q. Do you think the value of the stock was of value in excess of its book value?

A. I don't think so, no.

MR. WINSTEAD: No further questions, your Honor.

THE COURT: Thank you, Mr. Kelly.

MR. NATHAN: Your Honor, that concludes the case for the plaintiffs.

THE COURT: Does the defendant have any evidence?

MR. WINSTEAD: No, your Honor.

We'd like to make a motion.

THE COURT: All right.

Ladies and gentlemen, we are going to take a recess at this time.

At this time it will be necessary for the Court to confer with the lawyers and for them to make certain motions on the record and for them to prepare their closing arguments.

I think we will need about thirty minutes for that, so we will recess for thirty minutes.

(Thereupon, the Jury leaves the courtroom and the following proceedings were had outside the presence of the Jury.)

MR. WINSTEAD: Defendant would make a motion for directed verdict following the close of plaintiff's case for the reasons set forth in his brief and the Jury instructions [124] heretofore filed in the record.

MR. NATHAN: The Government rests its case?

MR. WINSTEAD: The Government rests.

MR. NATHAN: Plaintiff also wishes to file actually a written motion in connection with Rule 50 A for directed verdict in favor of the plaintiffs at the close of all of the evidence for the reasons set forth in this written motion and for the reasons set forth in plaintiffs' trial brief and in the Jury instructions.

THE COURT: The Court reserves ruling on the motions for directed verdict and judgment at the close of the plaintiffs' case and judgment for directed verdict at the close of all the evidence.

(Short recess taken.)

THE COURT: Be seated, please.

Plaintiff ready to proceed with closing argument?

MR. NATHAN: We are, your Honor.

THE COURT: Would you like to go ahead?

MR. NATHAN: If it please the Court, ladies and gentlemen, you've heard all the evidence, it's all in, all of the witnesses have testified.

We are near conclusion of the case, but I think before I start telling you why I believe we have proved the case that we set out to prove, I think there is one thing I have got to say to you that I feel impelled to say because [125] of the opening remarks that were made by the United States Attorney in the case.

I do not want you to have the impression that Allen Generes and his wife are seeking a tax advantage.

Now, those remarks were made in the statements that the net operating loss that is claimed here is a tax advan-

tage under the law. This is a statute enacted by the Congress of the United States. It has special provisions—we don't have to get into all the provisions of that—but these people are not seeking anything to which they are not entitled under the law if you find that this was a business debt.

In other words, I am trying to make this point clear, if you believe that the execution of that indemnity agreement was proximately related to Mr. Generes' trade or business as a salaried officer of Kelly-Generes, then it was properly a business debt and the law provides for this deduction for business debts; and it means if this is a business debt, Allen Generes and his wife have paid the Government almost \$50,000 more than they should have paid.

Now, that's enough to fight about, and reasonable men, I think, would fight about something like that.

Mr. Generes believes and we believe that we have shown this proximate cause, the proximate relationship, but my point here is it's not unfair, it's not as if you were [126] making a gift to this man, and we don't want a gift.

If you believe this is not a business—this is not a business relationship, I think Mr. Generes and I would say to you that we want you to find that it is not a business debt, but we don't believe that.

My point is, if our argument is correct, then this man has overpaid the Government, and I think all of us feel the same way about that.

If I went out and purchased a color television set that they were selling for \$500, I don't want to pay \$700.

Mr. Generes told you he has been paying income taxes since it went into effect, practically. He wants to pay his fair share.

We believe this is a statute authorized by Congress, we are asking only what he is entitled to. If he has overpaid, he is entitled to get the money; if he is not entitled to the business bad debt, he has not overpaid, and the Government has been paid the right amount.

So, that's up to you, it's in your hands to determine whether this is a business bad debt or not, but please don't think there are any favors or tax advantages involved, because that's not the case at all.

This is strictly a question of is it business or nonbusiness. We think it is business.

We called several witnesses. We called Allen [127] Generes, who testified and who told you about his many years in business, beginning in the construction business when he was a youngster working slowly and developing and how he branched out into other businesses. He actually has had several trades and businesses during his long lifetime.

One of these has been the construction business, beginning that years ago before World War I. He formed a partnership with his son-in-law during World War II in the construction business. It was called William F. Kelly Company.

It later became Kelly-Generes Construction Company, and they did business as a partnership, and throughout those years Allen Generes was paid a salary of \$12,000 a year.

In 1954, on the advice of counsel, he incorporated and so they changed their legal form and they became a corporation. They added I-n-c. to the end of their name. It meant instead of doing business as a partnership, they were now—they gave birth to a new entity, a corporation, and they issued stock.

Allen H. Generes owned 45% of the stock. He was not a majority shareholder. He was not a controlling shareholder.

William F. Kelly, whom you also heard testify, owned the exact same amount of stock, 45%.

The other three people in the corporation owned [128] approximately 3 point some odd per cent.

The total investment in that corporation in terms of stock was \$38,900. This was written off in the last year when the corporation went busted. You saw it. It's on Mr. Generes' return.

Thirty-eight thousand, nine hundred dollars was the value that that stock had in that corporation.

Now, think of that because that's important. This is what you are going to have to think of and use your common sense in measuring and evaluating this case.

This man had invested \$38,900. He was receiving \$12,000 a year. He had been receiving it since the 1940's, over a twenty-year period; that's \$240,000.

What do you think he was thinking about?

Do you think he was thinking that that salary, the \$12,000 a year, when we talk about investments? Suppose he had

taken \$38,900 and put it in the homestead, he is the President, and they were paying 5%. He would have made approximately \$1,900 a year, that would have been an investment making 5% on his money in the homestead.

He was making, I believe his testimony is to that effect, Mr. Black's testimony was to that effect, Mr. Cathcart's—of course Mr. Cathcart we had by deposition—all of these people will tell you which is more important, and to you and to me, what is reasonable to think here when a man has a [129] \$38,000 investment and he is making \$12,000 a year salary, which is he thinking more about, the salary or the investment?

And I think to me it is perfectly obvious that he is primarily thinking about the salary of \$12,000 a year.

When you think of an investment, I think in the terms of—suppose you went to Merrill Lynch or some other stock-brokerage house in town and you wanted to buy stock in a good company and you got in the Bank of New Orleans or General Motors or American Telephone and Telegraph, and you pay your money and buy the stock and own an interest in the company and collect dividends every three or four months. And then what happens? You hope your stock goes up.

And you maybe buy AT&T at a low price and hope it goes up so you can sell it in a few years. This is an investment. There is no doubt about it, but was Mr. Generes looking for dividends from Kelly-Generes?

Kelly-Generes absolutely did not in almost ten years in business, never once paid a dividend. This was not like American Telephone and Telegraph who pays millions of dollars to shareholders. This was not the case at all, Kelly-Generes never once paid a dividend.

Was that stock for sale? Could any of you go to Merrill Lynch and say, I'd like to buy stock in Kelly-Generes? It was not like that at all. No one could have bought it except the five people in the company who held the stock.

[130] Do they care whether this stock went up in value? Would it make a penny's worth of difference if it's worth a hundred dollars or \$5.00 a share? It makes a difference to you if you own AT&T or if you bought General Motors stock, you would be concerned whether General Motors went up in value. You'd like for it to be worth \$100 a share

instead of \$5.00, but did Kelly-Generes stock ever have a market value? None whatsoever.

The only importance that stock had was because it represented an ownership interest in the corporation, and this was a percentage, Mr. Generes had 45% and Bill Kelly had 45%. If they had split the stock or if they had doubled the stock or if they gave you five times as many shares for each person, it wouldn't make any difference, each man would still have the same percentage of interest.

If you think about this, it seems absolutely incredible that the Government takes the position that the man was primarily motivated by protecting his investment.

This man, I am convinced and I hope you are convinced, was primarily motivated by his salary of \$12,000 a year, and I think that this is our position in the case, the nature of the construction business is such that you simply cannot do business without bonds.

Now, you've had this hammered into you with the payment bonds and the performance bonds and what have you. [131] Mr. Generes had as part of his job for which he received that salary of \$12,000 a year to obtain the bonds for Kelly-Generes. Before they incorporated, it was never a problem. As partners, he was fully liable.

After they incorporated, the sole change that took place was that bonding companies wanted to go against more than the corporation. We want you in it. If you, Allen Generes, are not in it, we don't write bonds. His job was to get the bonds, and he knew that if he did not get the bonds what would happen, they could not have the construction work.

Bill Kelly testified to this. Mr. Generes testified to it. Durel Black testified to it. Without the bonds, no construction work.

If no construction work, what happens to Mr. Generes' salary, what happens to his position as an owner of this corporation?

Now, the Government gets up here and tells you—asks Mr. Generes did someone threaten to fire you, could you fire yourself?

This is my belief, I think it's absolutely absurd to ask us, could someone fire you.

Mr. Generes said, of course they couldn't. We have never

contended they could have. Mr. Generes himself said that, and he said, of course no one could fire him, but the very fact that the man could not be fired by a superior, there [132] was not somebody sitting there with a gun behind him and saying, now look, this is a condition of your employment, either you walk over and sign that bond or you are fired.

That didn't happen, but the very fact that it didn't, why is that material here?

Think of it as reasonable people, as a condition of his employment, if he did not sign those bonds, and he did of his own free will and accord, if he didn't sign bonds, no construction business, no contracts. If there was no construction business, there would be no company, no job.

It is no job working for a company that has no work. And this is, to me, tantamount. It's the same thing as if somebody were there saying, you've got to sign these bonds as a condition of your employment, and if you don't you are fired.

What difference does it make if somebody fires you or if you fire yourself, because business tells you you've got to do it and you say, well, I am not going to do it. If he didn't do it, he had no business.

If he didn't do it, no job as President of Kelly-Generes. If he didn't do it, he had no salary of \$12,000 a year.

Now, I think the Government is trying to play on an extremely emotional point, perhaps, when they tell you, did you need this money to live on?

[133] Did you have to have \$12,000 to live on?

There is nothing in the law that tells you you have to have \$12,000 a year, that that has to be—that that job has to be money that you have to live on or it's not connected with your business.

That is flat not true, and the Judge will instruct you, I think, accordingly.

There will be nothing in those charges to tell you that this must be essential to his livelihood, and I think Mr. Generes answered very, very properly when he said that there was a day when he lived on a lot less than that, and he could do so again if he had to.

The mere fact he doesn't need it to live on, it doesn't have one thing to do with whether this is a trade or business and whether they are related.

If I want to put aside \$12.00 a month in a homestead for my little girl to go on to college, I don't need it to live on, but I may consider it important, right? And I think if we get into it, the money may still come from my trade or business, it has no relationship to whether I need it to live on, it has nothing to do with what is my trade or business or what I may want. You see, there are different motivations.

What a man wants and what a man needs are two different things.

Actually, if you get right down to it, all a man [134] really needs ultimately is six feet of ground; but what a man wants in life is something else, and this man started work at 25¢ an hour and he worked himself—he worked himself up. He has built himself up to a very prominent local citizen, and he has had more than one trade or business, and this happens to be one of his trades or businesses, and that's perfectly proper for a man to have more than one trade or business, and the Judge will instruct you that the law says that a trade or business is that of being a salaried officer of a corporation, there is no dispute about that, the Government does not dispute that.

Mr. Generes had one trade or business as being President of Central Savings and Loan. He had another trade or business being the President of Kelly-Generes Construction Company, and there is no dispute that that is a trade or business of his.

The fact that he drew a salary from one, from Central, that is not in argument here. Whether he was underpaid or overpaid or whether he earned it or not, that is not an argument here. We are looking only at Kelly-Generes Construction Company and the salary he earned, and we are trying to determine whether this was related to the execution of those bonds and that is where you get into the heart of this case.

The Judge, I think, will instruct you on whether the [135] motivation, this is the problem, the motivation. What motivated Allen Generes? You have got as jurors, and I don't envy you, this task, you as jurors have got to get down into his mind, into his soul and determine what was the motivation.

Who knows what motivated him, that's why we have a Jury, that's why you twelve good men and true—twelve

good and true ladies and men have to decide this case. You have a rough decision, but a great thing to do. You have got to determine what it was that motivated that man, and you must determine whether, as a significant motivation, he wanted to preserve his salary of \$12,000 a year. Now, he may have had other motivations, that's perfectly okay. The law doesn't say anything at all about that being improper, and a man is a complex thing. We all have different motivations, and we are moved to do things for a number of reasons.

Some of them are good, some of them are bad. Sometimes we do the right thing for the wrong reason. Sometimes we do the right thing for the wrong reason, but a man can have a number of motivations, but the fact that maybe Allen Generes hoped that Kelly-Generes Construction Company would prosper, hoped some day it would pay dividends, that's a fine motivation, the fact that he hoped to build an estate to leave to his children, which I consider to be a very worthy, this is perfectly okay.

[136] The only question for you is not how many different motivations were there or how important were these other motivations, but whether it was the significant motivation on the part of Allen Generes to protect his salary as an officer of Kelly-Generes Construction Company, that is the key issue in the case, that is the heart, that is the nub of what this case is about.

And, of course, the Government takes a totally different view from us.

Our position is that it is a cold hard fact of the construction business that you've got to have bonds. To get the bonds, you have to have the personal indemnity to get—if you don't give the personal indemnity, you don't have the bonds, you don't have the contracts, you don't have the job.

Now, ladies and gentlemen, I appeal to your sense of logic, I think that there is a chain that goes from one event to the next, and I cannot see for the life of me how you can break this chain.

You are in the construction business, this is not an ordinary corporation, it's in the construction business, and you've got to have bonds. You've got to have indemnity agreements. Allen H. Generes knew that it is a necessity

of the construction business, it was essential, without it there is no business. That is essential to that business.

We then say, why does Allen H. Generes, knowing that [137] to be the case, why does he sign the indemnity agreements, what motivated him and set the chain in motion; he signed the indemnity agreement to get the bonds to get the contracts so that the company would have business.

I say to you that the relationship is that he did it because the next link in that chain was inevitable, he was getting paid \$12,000 a year as President of the corporation for the purpose of getting these bonds.

What were his duties? He was consulted on matters because of his many years of experience, but he basically only spent a few hours a week on the job because his primary job was lending his financial strength and credit to this corporation to get the bonds that they needed; and for those services his trade or business was rendering services for pay of \$12,000 a year.

He signed the bonds. For signing the bonds, the corporation paid him \$12,000 a year.

Now, when we talk about motivation, we talk about significant motivation. I submit to you that the Government is going to try to persuade you that this man was interested in his investment, and I think that it is—

I personally have been mystified from the time I have been in this, I have never been able to understand why or how reasonable men can take the position that you would be more concerned with protecting \$38,900 invested in a company [138] than you would with protecting \$12,000 a year salary, and it just doesn't make sense to me to think any other way.

So, I—I think, ladies and gentlemen, that our position is really very simple, that the execution of this indemnity agreement was every bit as important a condition of Allen H. Generes' employment of his continuing to obtain \$12,000 a year salary as if there had been someone there who said, either do it or you are fired.

I think that it was a condition because of the necessities of the business, because it was essential to the construction business.

It was essential because if he did not do it, there would be no salary, and this really is our position.

From 1954, think about this, from the year 1954 when they incorporated, from that time forward Allen H. Generes continued to sign indemnity agreements every time a contract was needed, he signed an indemnity agreement, and then he signed a blanket indemnity agreement in 1958. Over a period of over ten years he continued to sign indemnity agreements, from 1954 forward. He testified that from 1954 forward that corporation never once paid a dividend to him.

I submit to you that Allen H. Generes and William F. Kelly made a very good team.

Bill Kelly did the field work. He did the actual work in getting the jobs, in going out and seeing that the [139] jobs were done and performed.

Allen H. Generes had as his job, his job for which he rendered services for pay of \$12,000 a year, being President of that corporation, giving advice and consultation, lending his experience and primarily obtaining the bonds.

The indemnitors told you they would not write the bonds without Allen H. Generes.

Bill Kelly's financial statement was not in the same league. It was solely and strictly on account of Allen Generes' financial statement that every contract from 1954 forward required the signature of Allen Generes. The company did over \$14,000,000 worth of business during that period of time.

I submit to you that he received a salary, which as he pointed out on the witness stand in three years' time was almost the same thing as the amount of money he had invested in that corporation.

I am going to save a few minutes to talk to you again after the Government attorney has talked to you; but I submit to you that there can be no doubt, I believe, that the purpose, the primary motivation, the most significant motivation of Allen H. Generes in signing that indemnity agreement was to protect his \$12,000 salary a year.

THE COURT: Mrs. Bonomo, in view of the fact that we will likely finish today, if you would like to remain to [140] hear the rest of the closing arguments, you may, otherwise you may leave.

Mrs. BONOMO: I will leave.

THE COURT: Mr. Winstead, would you like to proceed?

MR. WINSTEAD: Thank you.

Your Honor, ladies and gentlemen, as Mr. Nathan told you, this is the time in the case where the Judge will instruct you on the law as to what constitutes business as opposed to non-business bad debts, and he will tell you that Mr. Generes does not qualify for business bad debt treatment with respect to the payment until he demonstrates that the signing the blanket indemnity agreement or the other indemnity agreements was proximately related to his trade or business. The test that you will be asked to apply to this is, was the signing—did the signing of the blanket indemnity agreement have as its significant motivating factor protection of his salary and status as an employee. That's the context of the case as the Judge will give it to you.

Now, in regard to this, the Judge will also tell you where the general majority or general stockholder makes loans to his corporation, signs indemnity agreements on its behalf guarantees its notes, as you heard Mr. Generes say he did by borrowing for his corporation, that this gives rise to non-business bad debts deductions. This is the general rule. [141] Now, the reason for the rule, ladies and gentlemen, I think you can see quite obvious. If you have a dominant and majority stockholder—don't let Mr. Nathan fool you because Mr. Generes only had 45% of the stock, he was not one of the dormant stockholders. Each had 45% of the stock and the other stock was spread out.

The reason for the rule is that a person who has this sort of interest in a corporation is obviously interested in protecting—in protecting his investment in that corporation, and tries to see that the company will continue in operation so the value of the stock will go up, so that the company will eventually pay him dividends; so that he can leave the stock to his family, any of the number of factors.

These are all factors that go to investor activity, and that is the reason for the rule, the general rule that where a majority, dominant stockholder makes such loans or signs indemnity agreements he is looking to protect his investment.

I think also—I think Mr. Nathan has told you a half-truth. He states that Mr. Generes' investment in the corporation was \$38,000.

Now, that's the capital stock in the corporation, that's

the money paid in for stock, and he would have you believe that it's a \$12,000 salary as opposed to a \$38,000 investment in the corporation, it only takes three years to [142] pick up \$38,000. Ladies and gentlemen, let me tell you this, the amount of capital stock which an individual happens to own in the corporation or the amount of the corporation's capitalization has nothing to do with the value of the stock or the value of his investment in that corporation.

Now, you heard these people testify that this corporation had completed contracts of \$14,000,000. Now, that's a substantial return on a \$38,000 investment. I think you will agree, in fact, it's ludicrous to assume that that was the amount of the investment.

Also, Mr. Generes had loans of about \$150,000, this he was also protecting.

His loans were put in the company as part of his investment to keep the company going, and Mr. Nathan would have you believe that \$38,000 sitting out here as opposed to \$12,000.

Also, Mr. Generes is a 45% stockholder.

You heard the testimony as to the assets owned by the corporation, over one million dollars worth. Mr. Generes is a 45% stockholder of those one million dollars' worth of assets.

I ask you whether his investment in that corporation was substantially more than just \$38,000!

Mr. Nathan objects to the use of the words "tax advantage" with respect to the net operating loss. I dare [143] say very few of you have used a net operating loss. It is limited by the statute to business bad debts, and the Congress has taken great care to segregate out for this special treatment the business deductions which a taxpayer incurs which enables him to go back and take deductions from one year and carry back two years or three years and use them in another year. In that regard, I told you to begin with the non-business bad debt provision, and the word non-business has nothing to do with the fact it's not business motivated in the sense of earning money. Non-business refers to many debts, and the Judge will instruct you about these debts other than between friends or where you don't intend to be repaid.

Don't let the word non-business lead you to believe that

it deals with debts that aren't bonafide. This was a bonafide obligation but it still, in our opinion, was a non-business bad debt.

Now, another thing that the Judge will instruct you about and which I mentioned to you in the beginning, and it gets very confusing in the case, is the difference between the business of the corporation and the trade or business of the people who work for it such as Mr. Generes here. Now, I think many of you may be assuming that since Mr. Generes was in the construction business through partnerships and in the company that his trade or business is construction work.

[144] It is not, that is not his trade or business, and you must find in this case that this particular bad debt or payment was related to his trade or business, and I think the testimony was quite clear that what the necessity for this indemnity agreement was was so that the company, Kelly Generes Construction Company, could carry on its business. This is why the indemnity agreement was signed, so the company could carry on its construction business.

Mr. Generes uses the word "we" all the time. I asked him what "we" meant; he said the corporation.

This is why the indemnity agreement was signed, so the corporation could do business.

Now, Mr. Nathan groups a lot of these concepts all together and he called this a chain. Well, ladies and gentlemen, I want you to see how long this chain is.

First of all, they tell you Mr. Generes had to sign indemnity agreements or Maryland Casualty Company would not have issued bonds for their construction work, for the construction work of the company, Kelly-Generes, right?

The next step is if the bonds had not been issued, Kelly-Generes Construction Company could not have obtained contracts for construction work, again Kelly-Generes Construction Company could not have obtained construction jobs.

Thirdly, if Kelly-Generes Construction Company could not obtain jobs, the company would go bankrupt, go in- [145] solvent, again Kelly-Generes goes insolvent.

The fourth step in the chain is when Kelly-Generes Construction Company goes bad, defaults, the employees

lose their jobs. Well, of course, when they all lose their jobs, the company is not in existence.

Now, we say this chain is so long and it's so indirect to Mr. Generes' objective in signing this—immediate objective in signing the indemnity that it's not proximately related to the trade or business of being an employee.

When he signed that agreement, his concern was so that the Kelly-Generes Construction Company could obtain bonds and do construction work. He was no more concerned about his salary at that time than I am right now.

He was thinking about his company. This blanket indemnity agreement was just done up for his convenience. At the time he signed that thing, he was no more concerned about his salary than I am right now.

As the Judge will tell you—let me also say this first.

Mr. Nathan has also done something, I think it may be a little confusing to you, he tells you that Mr. Generes' job with this company was to secure the financing and secure the bonds.

Now, this was what, if you want to use the Federal Government's term for his job description, this is what he [146] did and he got a salary, right? But this does not mean that the reason he put his name on the indemnity agreement was to protect that salary.

He could do it to protect his investment just as well, and we think he did.

Mr. Kelly's job was not one of getting bonding. He put his name on that indemnity agreement, but that wasn't within his job description, likewise it was to protect his investment. Don't be confused by the fact what Mr. Generes did for the company was to secure bonds, Mr. Generes could have been in Kelly's position. He could have been the man on the job.

He had the assets that Maryland Casualty Company was interested in, so they went after him. So what he did for the company we don't feel is relevant, and I think taking the fact that he got paid for it doesn't mean by signing the indemnity agreement he was protecting the salary he was getting.

As I said, the Judge will tell you that it must be a significant motivating factor, the protection of Mr. Generes' salary must have been a significant motivating factor in order for him to recover, and we don't think that the protec-

tion of the \$12,000 a year salary was in any way significant compared with anything else. He had to begin by signing this indemnity agreement.

[147] And let me also say this, I don't want you to feel—I know Mr. Generes thinks this is a horrible thing that he had to pay \$162,000, no one would wish this on anyone, I don't want you to think that the Government or the Internal Revenue has disallowed this, we have allowed him a deduction for a non-business bad debt, and they want a business bad debt.

We have not denied a deduction. I think we have allowed him a deduction which he was properly entitled to.

Now, going to the evidence as to what motivated Mr. Generes, I mentioned a number of factors to you, which I told you I thought you should focus on during the course of the trial.

As I told you, the things that motivate men are the things that happen around them. I think it was quite clear from the testimony that Mr. Generes was not motivated to sign this indemnity agreement because he was afraid of losing his job.

No one in the company was in the position to tell him that, you are fired if you don't sign this indemnity agreement. There was no one. He said, I could fire myself.

In other words, Mr. Generes imposed the conditions of his own employment, the amount of his own salary, he could up it to \$50,000 if he felt like it, if the company had the money. So, I—he obviously was not threatened with the [148] loss of his job.

He had control over his own job and his own salary.

The next thing, I think it was obvious, Mr. Generes talks about this job of his and how much time he put in the Kelly-Generes Construction Company, I think you saw from his testimony with respect to the corporation how well it was doing from 1958 through 1962. The corporation was not 'doing that well, ladies and gentlemen, as I demonstrated to you from the tax returns.

Now, Mr. Generes would tell you that he was an active employee of the corporation trying to earn a salary and signing indemnity agreements to protect that salary; yet, he doesn't even know whether the corporation is making money or losing money.

The next thing I think is quite significant, since the ques-

tion before you is whether he was trying to protect his salary, this is the fact that he was receiving \$19,000 a year from Central Savings and Loan Association, and he testified that the \$12,000 was not needed by him.

Now, the question for you is what motivated him in signing the indemnity agreement. Now, here is a man who will tell you, I don't need the \$12,000 and then turn around and say it's to protect my salary, a salary he just told you he didn't need.

No, I think this is very significant in determining [149] what motivated Mr. Generes in signing this indemnity agreement.

In addition, I think you gathered from Mr. Generes' testimony that here was a man who would hardly be concerned with salary, irrespective of his tremendous investment in the company.

Is this a man who would be concerned about his \$12,000? He mentioned to you the \$19,000 income from Central Savings. He told you he had real estate which paid him—I forget how many thousand dollars a year, something to that effect, he also tells you here is \$38,000 sitting right here in the stock of Central Savings and Loan Association, that here you saw in 1956, \$55,000 in cash in the bank, and you heard testimony from the Maryland Casualty Company, the reason they went after him is because he had, in his own words, \$35,000 on the average in his bank accounts. Yet, he will have you believe when he signed that indemnity he was trying to protect \$12,000 a year salary, which he said he didn't need.

Another thing, ladies and gentlemen, this is the same thing that I was talking about a minute ago, I asked you how much time he spent on this job he is trying to protect.

He is President of Central Savings and Loan, putting in a full-day's work there. He spends—his testimony changed so many times between the time we took his deposition [150] and his testimony here, I don't know what to believe. Now, he told us in the deposition about an hour a week he spent doing this.

Now, he says four or five hours a week, but anyway the point is he wasn't spending any time and effort with respect to this corporation's activities.

The Judge will charge you as to what the trade or busi-

ness means, and a part of the definition is the time and effort put into it.

I want you to keep that factor in mind. I think, since our position is that Mr. Generes was attempting to protect his investment, I think you should add up what he was protecting by signing these indemnity agreements.

As I told you, that \$38,000 in stock is quite misleading, that may be the stock that's on the books, the paid-in capital to get the stock out, but that has nothing to do with assets owned by this corporation or any earned surplus, it has all of these things, which Mr. Generes as a 45 per cent stockholder has that interest in, so don't you believe it is \$38,000 that Mr. Generes had riding on this.

If you can show me a \$38,000 investment that produces \$14,000,000 of business, I wish you'd tell me about it. I'd love to see it, and I would also, if you can show me a \$38,000 investment where I also have a 45% interest in over a million bucks of assets, I wish you could come and tell me [151] about that.

To be brief, Mr. Generes was protecting that investment in that corporation.

Another thing, I read you in his deposition that he stated he was protecting his investment to build up his investment, I believe, and also—for his family.

Now was this a motivation of his?

Here he has his children or his sons-in-law and one of his own sons in the family corporation receiving salaries to live on that his children can live on. Now, would this motivate a man to sign an indemnity agreement to keep the company going?

This was in the nature of his investing in the corporation to keep it going, it wasn't motivated by a desire to keep his salary, it was his desire to keep the company going so the children can earn money from it, so the stock will go up in value and eventually pay dividends.

You saw here when Mr. Generes testified, I asked him if he hoped the corporation would pay dividends. He said, no.

Again, I don't know, for the nth time I asked him in his deposition and read to him where he said he hoped eventually the company would pay dividends.

Mr. Nathan tells you it is not necessary to hope for dividends, that's true, but by the same token, there are [152]

many stocks that don't pay any dividends at all that you could seek to protect, purely gross stock money, leave it in the corporation, it will pay no dividends, but by reason of the corporation doing business and earning money, the value goes up, it doesn't have to be in the form of dividends.

Mr. Generes' investments produced money by just having the company keep going and earning money and the stock going up.

The idea that there was no fair market value for that stock just appalls me. If we are going to talk about any evidentiary statements, that's got to be the catch right there, because that stock had a fair market value equivalent to the assets in the corporation, and you can't tell me they could sell out tomorrow—it doesn't mean that they have to, it's a family corporation—but the idea that the stock didn't have any value, ladies and gentlemen, is ridiculous.

Finally, ladies and gentlemen, I think when you add all of these things together in determining what motivated Mr. Generes, I don't believe you can come up with any other conclusion but that what the reason he executed that indemnity agreement was to keep that construction company going, his family corporation, so that his children could work it in and the stock would go up in value, these are the reasons that motivated Mr. Generes in signing that indemnity agreement, not to protect that \$12,000 per year salary, which he said he [153] doesn't need.

Now, Mr. Nathan is going to talk to you again for just a minute, but I'd ask you to keep in mind now what I told you.

It is somewhat of an advantage to get the last shot at the Jury, but I want you to keep in mind what I told you our contention is as to what motivated Mr. Generes, and I think that the signing of the indemnity agreement was not proximately related to Mr. Generes' trade or business of being an employee, it was related to the business of Kelly-Generes Construction Company so it could operate, and indirectly Mr. Generes kept getting his salary, but this is not, ladies and gentlemen of the Jury, the proximate relationship, we think, sufficient to qualify for a business bad debt deduction.

Let me say in closing, I want to thank you for coming down today. It was very nice having you here today and I appreciate your taking the time to come here.

Thank you very much.

MR. NATHAN: Ladies and gentlemen of the Jury, I will only take about another two or three minutes to sum up, since this is all the case is about, whether this is to protect Mr. Generes' salary or investment.

I am amazed at the Government's position about the investment.

[154] I am beginning to wonder now if Mr. Winstead knows what an investment is when he tells you this is a million dollar corporation because it has a million dollars worth of assets in it.

Now, the balance sheet does not show that the stock was worth a million dollars because the corporation had a million dollars worth of assets.

You have to look at the mortgages on it. If you have a million dollars worth of assets and \$1,500,000 liabilities, you are in bad shape, and this corporation had mortgages.

Mr. Generes testified and Mr. Kelly testified that they bought equipment and that they had mortgages placed on this when they acquired their property.

And in the very evidence the Government submitted, this tax return for the year 1962, the stock in the corporation was valued at \$38,900, and that is in the return, that's their evidence that they submitted, and that was the value placed on the stock.

Now, we certainly grant you that the corporation had more than \$38,000 in it. It had to.

We haven't actually had evidence here about the nature of the equipment and what was in it or what was not in it, the only evidence in the record shows that there was—there were assets and that many of those assets were [155] almost up to the hilt with mortgages, they were encumbered, so that stock—you've got to take on the evidence before you—that stock was valued at \$38,900.

Mr. Winstead knows it and I did not try to mislead you at all.

This was the Government's evidence, and that was the value placed on the stock.

Now, I think Mr. Winstead may have misled you when as talked about the loans Mr. Generes made to the corporation. Why, he said certainly he loaned them \$150,000, but this was, you remember, at the very end of the game, this was when the corporation was finally going under, but

throughout those years, Mr. Generes testified, the only times he made loans was when the corporation needed these quick assets, then they had it generally for a short time.

So, it seems to me that in spite of the various evidence, Mr. Winstead gave you a lot of instructions about the law and what the law may be, I want to insist again that the Judge is going to charge you on what the law is in the case and how to apply it.

I have tried to avoid that as much as possible, and I tried to stick to the facts, because what we are talking about here is a question of fact: What was the primary motivation for Allen H. Generes to sign the indemnity agreement?

Now, when he tells you that the Government has not [156] disallowed a deduction, that is not completely correct. Allen Generes has paid \$50,000 to the Government under protest and he has claimed that he is entitled to a refund because they have disallowed a deduction for a net operating loss, that is what this is about.

I have told you this is a part of the statute, it is not an unfair advantage, there is nothing about it in that sense, it's either—and this is up to you, if Allen Generes is entitled to a business bad debt to claim that the signing of the indemnity agreement was proximately related to his position as an officer and director of Kelly-Generes Construction Company, then he is entitled to have this treated as a business bad debt.

The law says that is what he is entitled to. If you so find, and if he is—if it was not proximately related, then he is not entitled to a business bad debt.

Whatever Mr. Kelly's motivation was, that is not before you. He was not called upon to testify as to his motivations.

You, as ladies and gentlemen of the Jury, are called upon to determine what was the motivation of Allen H. Generes, and you've got to determine whether the execution of that indemnity agreement was significantly motivated by the desire to preserve and protect his salary of \$12,000 a year.

[157] I have told you, and I think it's perfectly reasonable, a man can have more than one motivation, more than one reason, he may be interested in the stock paying dividends, he may be interested in having it pay dividends and passing it on to his children, it's perfectly worthy and honorable, and I say more power to him.

The question was, what was the significance,—what was —was it significantly motivated, that's all you've got to find.

Mr. Winstead got up and made like an accordian (indicating) to show how long the chain was. We never denied that Allen H. Generes signed the indemnity to get bonds so the company could do business. Certainly he wanted the company to continue in business, but was he significantly motivated in wanting the company to continue on in business because he wanted to preserve his \$12,000 a year salary? I submit he was.

Ladies and gentlemen, this case is now going to go into your hands, and I hope that when you retire to the Jury room, after the Judge has instructed you, that you will bring your good common sense to bear on this question.

It is, as I said at the outset, extremely difficult to peer into a man's soul or emotions to tell exactly what motivated him. I think you've got to gauge yourself by what the man himself says, a man of character, a man of prominence [158] in the community, when he tells you what motivated him, and from the facts and circumstances and the testimony of the men who did business with him, the people who knew him, and from all of the circumstances.

I submit to you there is no reasonable conclusion that can be drawn except that the execution of this agreement was proximately related to his business of rendering services for pay for which he was receiving \$12,000 a year.

THE COURT: Ladies and gentlemen of the Jury:

Now that you have heard the evidence and the arguments of counsel, the Court will instruct you as to the governing law in this case.

Although you are the sole judges of the facts, you are duty bound to follow the law given in the Court's instructions and to apply that law to the facts as you may find them from the evidence. You are not to be concerned with the wisdom of any rule of law, for regardless of any opinion you may have as to what the law should be, it would be a violation of your sworn duty to follow any other view of the law than that given in the Court's instructions.

The fact that the plaintiffs are private individuals and the defendant is the United States, should not enter into or affect your verdict.

The plaintiffs and the defendant are equal before the law, and each should be given the same fair and equal [159] treatment by you. You are to decide the case solely and exclusively upon the evidence, except that you should be guided at all times in your deliberations by the law as the Court gives it to you.

The evidence consists of the sworn testimony of the witnesses, all exhibits which have been received in evidence, all facts which have been admitted or stipulated, and any applicable presumptions stated in these instructions.

Any evidence as to which an objection was sustained by the Court, and any evidence ordered stricken by the Court, must be entirely disregarded.

The statements and arguments of counsel are not evidence.

You are to consider only the evidence, but in your consideration of the evidence, you are not limited to the statements of the witnesses, on the contrary, you are permitted to draw from the facts, which you find have been proved, such reasonable inferences as seem justified in the light of your own experience.

As jurors, you are the sole judges of the credibility of the witnesses and the weight their testimony deserves. A witness is presumed to speak the truth. But this presumption may be outweighed by the manner in which the witness testifies, the character in which the testimony was given, or by contradictory evidence.

[160] You should carefully scrutinize the testimony given, the circumstances under which each witness has testified, and every matter in evidence which tends to indicate whether the witness is worthy of belief. Consider each witnesses' intelligence, motives and state of mind, and demeanor and manner while on the stand.

Consider also, any relation each witness may bear to either side of the case, the manner in which each witness may be affected by the verdict, and the extent to which, if at all, the witnesses' testimony is either supported or contradicted by other evidence.

It is the duty of the attorneys on each side of the case to object when the other side offers testimony or other evidence which counsel believes is not properly admissible.

When the Court sustained an objection to a question, you

are to disregard the question and draw no inference from the wording of it or speculate as to what the witness would have said if permitted to answer.

If I allowed testimony or other evidence to be introduced over an objection, this does not indicate any opinion on my part as to the weight or effect of that evidence.

You are the sole judges of the credibility of the witnesses and the weight and effect of the evidence.

There is only one issue presented for decision in this case. Your verdict will be in the form of an answer to [161] a question that I will give you when you retire to the jury room to deliberate.

I will now proceed to tell you the law applicable to that particular question.

Now, the question that will be submitted to you, ladies and gentlemen, is short, and I think it will be readily understood by you:

"Do you find from a preponderance of the evidence that the signing of the blanket indemnity agreement by Mr. Generes was proximately related to his trade or business of being an employee of Kelly-Generes Construction Company?"

You are to answer that yes or no.

When you answer it, your answer must be unanimous.

You will select a foreman upon retiring to the jury room, and he will preside over your deliberations and act as your spokesman in Court.

Nothing said in these instructions, nothing in the question, is to suggest or convey in any manner or way any indication as to what verdict I think you should find. What the verdict shall be is the sole and exclusive duty and responsibility of the Jury.

Now, ladies and gentlemen, I have to give you some special instructions that the parties have requested that are somewhat lengthy and I know you have been listening to a lot of talking, let me suggest that we take a little stretch before [162] we hear the rest of the charges.

(Short recess taken.)

THE COURT: It has been called to my attention that one or more of you may have cars in parking lots that close early, if any of you have this problem, if you will give your

keys to the Marshal, he will move your car to another lot which will be open later.

It is unfortunate that we can't make this as interesting as an hour and a half TV spectacular. Lawyers' and Judges' talk is rather dry, but we will soon, I think, be finished.

It is your duty, as jurors, to consult with one another and to deliberate with a view to reaching an agreement, if you can do so without violence to your own individual judgment. Each of you must decide the case by yourself, but do so only after an impartial consideration of the evidence with your fellow jurors.

In the course of your deliberations, do not hesitate to re-examine your own views and change your opinion if convinced it is erroneous. But do not surrender your honest convictions as to the weight or the effect of evidence solely because of the opinion of your fellow jurors, or for the mere purpose of returning a verdict.

The only issue in the case is whether the payment in 1962 of \$162,104.57 to Maryland Casualty Company by Allen H. [163] Generes gave rise on the one hand to a business bad debt deduction or a deduction arising out of a transaction entered into for profit, which is treated in the tax law as a business bad debt, or whether it gave rise on the other hand to a non-business bad debt deduction.

As you have heard, Mr. Generes paid this money to Maryland Casualty Company under his obligation under the blankét indemnity agreement. When he paid it, under Louisiana law, he became subrogated to the rights of Maryland Casualty Company against Kelly-Generes Construction Company. This means he became a creditor of Kelly-Generes Construction Company.

He could not collect this money from the company and this has given rise to the bad debt deduction involved in this lawsuit.

The Government has, as you have heard, not denied a deduction to plaintiffs for this payment, but rather has allowed it as a deduction for the worthlessness of a non-business bad debt in the year 1962.

Mr. and Mrs. Generes contend that the deduction should have been allowed as a business bad debt or a bad debt from a loss incurred in his trade or business.

The tests for an allowance as a deduction as a business bad debt or as a loss incurred in a trade or business are the same, the differences between them are merely [164] technical, and I shall refer to the deduction on either basis as a business bad debt, as distinguished from a non-business bad debt.

Now, as you understand from the arguments of the attorneys, the significance of characterizing the bad debt as a business bad debt rather than as a non-business bad debt is that only business bad debts are available for what is known as a net operating loss carryback.

You need not be concerned with this, but suffice it to say that it enables taxpayers, such as Mr. and Mrs. Generes, to take unused business deductions from one year, here 1962, and transfer them to other years, namely, 1959, 1960 and 1961, in order to obtain the benefit of the deductions in prior years and a refund of taxes paid in prior years. This explains why the payment involved in this transaction occurred in 1962 and the taxes involved in this controversy relate to the years 1959, 1960 and 1961.

But, as you have heard, the one thing you need to do here is answer the question put to you yes or no with respect to whether this is a business bad debt.

The plaintiffs in the suit seek a refund of income taxes in the approximate amount of \$50,134.49. As you know, the plaintiffs are Mr. Generes and his wife, and Mrs. Generes is joined as a plaintiff simply because she is Mr. Generes' wife and filed joint tax returns with her husband [165] for the years in question—as well as a separate return for one year. She is not actually involved as a party except because of her status as Allen Generes' wife. Thus, when I speak of "the taxpayer," I mean Allen Generes, and whatever you decide with respect to Mr. Generes will apply also to his wife.

The Commissioner of Internal Revenue levied an additional assessment of taxes against the plaintiffs for the years 1959, 1960 and 1961; subsequently the plaintiffs paid this in full; then they filed these claims for refund of these taxes and the Internal Revenue Service denied these claims for refund. Therefore, the plaintiffs are now suing for a refund of the taxes which they have paid under this assessment.

This is not an action instituted by the Government, but rather one instituted by the plaintiffs, Mr. and Mrs. Generes, against the Government. In short, the plaintiffs have paid all the income taxes which the Government says they owe, and they now seek to recover a portion of those taxes which they say the Government has wrongfully retained or refused to refund.

They claim that the Commissioner of Internal Revenue erroneously disallowed their claimed deduction of \$162,104.57 in the year 1962 and that this resulted in a net operating loss for 1962 which should have been carried back to other tax [166] years, and which should have resulted in a refund of the amount sued for.

As I mentioned to you at the start of this case, this is a Civil Action that involves only a difference of opinion between the plaintiffs and the Government over the appropriate tax treatment of the amount in question.

The Government has not accused Mr. and Mrs. Generes of tax evasion of any kind.

The only question which you must decide is whether the bad debt involved should be characterized as a business bad debt or as a non-business bad debt. Now, the term "non-business bad debt" that we have been using throughout this trial means simply all those debts which are not either created or acquired in connection with a trade or business of the taxpayer or the loss from the worthlessness of which is not incurred in the taxpayer's trade or business. The character of a debt is thus determined by the relationship which the loss resulting from the debts becoming worthless bears to the trade or business of the taxpayer.

The primary test for you to apply is stated as follows:

If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is considered a business debt and the loss is a business loss.

[167] You must therefore determine whether the obligation of Mr. Generes to indemnify Maryland Casualty Company was created, acquired, or incurred in a trade or business of Mr. Generes, that is whether it was incurred as a proximate result of his trade or business.

In determining whether a debt is a business or a non-business one, you should not consider the term "non-busi-

ness" as referring only to debts between friends or members of a family. "Non-business" does not mean the absence of a desire to make a profit from loaning money, from guaranteeing the loans of others, or from signing indemnity agreements. The term "non-business" refers to many debts between unrelated persons or between persons attempting to make a profit by lending money, guaranteeing the loans of others, or signing indemnity agreements.

In short, the term "non-business" does not mean that no valid debt or obligation exists; it does not mean that the debtor and creditor did not deal at arm's length, it does not mean the lender, guarantor, or indemnitor did not want to earn money from his activities.

The question whether this debt was a business debt or a non-business debt is a question of fact for you to decide. It must be based upon your determination of whether the loss was proximately related to the conduct of a trade or business in which the taxpayer was engaged.

[168] The non-business bad debt provisions were designed to prevent the full deductibility of a bad debt where the debt had no proximate relation to or was not a proximate result of the activities which the tax laws recognize as a trade or business, for every income or profit-making activity is not a trade or business. A debt is proximately related to the taxpayer's trade or business when its creation was significantly motivated by the taxpayer's trade or business, and it is not rendered a non-business debt merely because there was a non-qualifying motivation as well, even though the non-qualifying motivation was the primary one.

Under the applicable provisions of the Internal Revenue laws, in order for a bad debt to be deductible from the plaintiff's income as a business bad debt, it must first be shown that the plaintiff is regularly engaged in a trade or business and secondly that the debt arose, was created, or acquired in connection with that trade or business. Stated otherwise, there are two requirements for business bad debt deductions.

First, the activities of the taxpayer, with respect to the corporation on whose behalf he signed the indemnity agreement must constitute the carrying on of a trade or business within the meaning of the tax laws.

Secondly, his entering into this indemnity agreement,

must have been directly or proximately related to those [169] particular activities of the plaintiff which are considered his trade or business.

An example might better demonstrate the existence of a second requirement for a business bad debt. Let us assume that I am in the business of buying and selling used cars and that I made two loans, one to a customer to whom I agreed to extend credit when he buys a car; the second to a friend to enable him to buy a new car from a new-car dealer, from someone else who is selling new cars rather than from me, who is selling used cars. Assume that both debts become uncollectable in the same year.

While I am admittedly in the business of buying and selling used cars, only the money I lend my customer to buy a used car which is deductible as a business bad debt, since it alone was proximately related to my trade or business of attempting to make a profit on the sale of used automobiles. The other loan, the one I made to a friend or another customer to buy a new car from someone is a non-business bad debt, since loaning money to someone to purchase a new automobile from another automobile dealer has no relationship to my business of selling used automobiles. While the second debt was a valid and enforceable obligation, with a complete stranger, and from which I hoped to make a profit, it is nevertheless a non-business bad debt.

With respect to the requirement that the activities of the taxpayer must constitute a trade or business, you are [170] instructed that rendering services for pay does constitute a trade or business. An officer of a corporation who receives a salary as such is considered in the eyes of the law to be engaged in a trade or business—the trade or business of rendering services for pay.

There is no dispute between the parties that Allen H. Generes was engaged in a trade or business as a corporate officer of Kelly-Generes Construction Company, the trade or business of rendering services for pay.

Now, at this point, I must caution you that there is a distinction to be drawn between the business of the Kelly-Generes Construction Company and the business of Allen H. Generes, individually. The corporation is in the construction business and Mr. Generes was employed by and owns stock in that corporation. I think almost all of you are employees of some company. You have a business of

rendering services to that company, that company has a business which is distinct from your own employment.

In Mr. Generes' case the fact that he was working for a construction company does not mean that he was in the construction business.

Mr. Generes' trade or business was that of an officer-employee rendering services to the corporation for pay.

If a taxpayer's trade or business is that of rendering services for pay, a loss or debt may be proximately related to that trade or business if it was necessary for the taxpayer to incur that debt or the obligation on which it was based in order to maintain his employment. The mere fact that the taxpayer was a shareholder in the company and thus could not be "fired" is not controlling, although it is a fact that you may consider.

A debt is also proximately related to the taxpayer's trade or business if incurring it is essential to the taxpayer's trade or business; in that case it can be said to have been incurred "in connection with" that trade or business.

A debt is a business bad debt if the debt, or the activity giving rise to the debt, is such that without the taxpayer assuming or acquiring it his trade or business would no longer be able to operate in the manner in which it is intended to operate.

In determining whether this is so in this case, you must, of course, apply this rule to Mr. Generes' own trade or business, not to the trade or business of Kelly-Generes Construction Company. Those two businesses, Mr. Generes' own business as an officer-employee and that of Kelly-Generes Construction Company are, of course, separate and distinct.

The question here for you to decide is whether Mr. Generes' signing of the indemnity agreement with Maryland [172] Casualty Company was proximately related to his trade or business of being an employee of Kelly-Generes Construction Company. Not every act of an employee is proximately related to his business of being an employee.

For example, if I were employed by Sears Roebuck Company and went out and bought some stock in Sears Roebuck, I am performing an act that has some investment advantage to me, but this is not necessarily related to my employment with Sears Roebuck Company. On the contrary, in that circumstance I am becoming an investor in the company, and

as such, the act of buying stock has no direct or proximate relationship with my trade or business of being an employee.

So, in the present case, you must decide whether Mr. Generes' signing of the indemnity agreement with Maryland Casualty Company was proximately related to his trade or business of being an employee of the company or whether the signing of the indemnity agreement was related to his capacity as an investor in the company.

Of course, the important thing for your consideration is what constitutes a sufficient relationship between the trade or business of being a corporate employee and the act of signing the blanket indemnity agreement such that the bad debt resulting therefrom should be considered a business bad debt.

Loans by a shareholder to his closely held corporation generally give rise to non-business debts. This is because an investor as such is not engaged in a trade or business. Where, however, a stockholder who is also an employee of the corporation makes such a loan—or, as here, executes an indemnity agreement—the debt is a business debt if it is proximately related to the trade or business of being an employee. [173]

The question for you then becomes whether Mr. Generes' signing of the blanket indemnity agreement was done in his capacity as a shareholder or investor in Kelly-Generes Construction Company or in his capacity as an officer-employee of Kelly-Generes Construction Company rendering services for pay.

Among the factors that you may consider and should consider, in addition to those that I have already mentioned, in determining whether Mr. Generes' motivation was to protect his salary and job or to protect his investment are as follows:

Whether it was a part of Mr. Generes' duties as an officer and employee of Kelly-Generes Construction Company to secure financing for the company and obtain bonds for the company's construction projects.

Whether signing the indemnity agreement was a condition of Mr. Generes' employment by the construction company.

Whether Mr. Generes, as an officer, director, and stockholder in the company, was in such a position that he [174]

could have himself determined the conditions of his employment!

Whether when Mr. Generes signed the indemnity agreement, was he motivated significantly by a desire to protect his salary or whether his motivation was predominately one of protecting his investment and future gain or investment as distinguished from his salary as an officer-employee?

What was the amount of Mr. Generes' investment in the company which he would be protecting by signing the indemnity agreement, and what was the amount of annual salary he would be protecting thereby?

While you should consider all of these factors and the other factors I have discussed with you as they bear on Mr. Generes' motivation for signing the agreement, you should not consider any single factor as controlling in reaching your decision.

It is obvious from the testimony in this case that construction companies such as Kelly-Generes Construction Company cannot operate without bonding agreements such as provided by Maryland Casualty Company. It is also obvious and not disputed that companies, such as Maryland Casualty Company, often require individual owners of the bonded companies to execute indemnity agreements such as the one involved here, in which the owners of the bonded company agreed to hold harmless from loss the bonding company.

[175] It is also clear and not disputed that without the signing of these indemnity agreements by owners, such as Mr. Generes, bonds could not be obtained for construction jobs, and the company, here Kelly Generes, could not obtain construction jobs, and would therefore eventually go out of business, and, of course, the employees of the company would lose their jobs and their salaries.

In this sense there is a relationship between the signing of the indemnity agreement by Mr. Generes and the continued existence of his job and salary.

You may take this relationship into account as one of the facts to be considered by you in determining the relationship between the signing of the indemnity agreement and the protection of Mr. Generes' job and salary, but it is not of itself controlling any more than any other factor I have

mentioned to you in establishing whether or not the debt was proximately related to Mr. Generes' employment.

In determining the purpose or motivation of Mr. Generes in signing the indemnity agreement, you may consider what he did as well as what he said. In other words, his purpose and motivation is to be gathered from all the circumstances of this case, including what he did as well as what he said, and you are not bound merely by what he said about his motive or purpose.

In order to justify a verdict in his favor, Mr. [176] Generes must prove each of his contentions by a preponderance of the evidence.

To establish something by a preponderance of the evidence, means to prove that something is more likely true than not true.

In other words, a preponderance of the evidence means such evidence as when considered and compared with that opposed to it, has more convincing force and produces in your minds the belief that what is sought to be proved is more likely true than not true.

If the evidence is equally balanced and you are unable to determine in your minds which way the scale should turn, then, the plaintiff has failed to carry his burden and the Court instructs you that you must find for the Government.

Now, ladies and gentlemen, it's my duty at this time to give the lawyers a chance to suggest whether there is anything else that needs to be added to what I already told you in length.

If you will retire to the corridor one moment without beginning your deliberations, we will see if there is anything to be added, and then we will ask you to return to the courtroom before beginning your deliberations.

(Thereupon, the Jury leaves the courtroom.)

THE COURT: Gentlemen, are there any matters other than those already called to my attention in chambers?

[177] MR. WINSTEAD: The only thing I caught as you—I am concerned about the charge being correct.

I believe you stated that on the deduction for a transaction entered into for profit there would be the same tax treatment for a business bad debt, and the law says—the Court stated in the charge that there could be a business bad debt deduction or a deduction arising out of a transac-

tion entered into for profit and that the tax treatment would be the same—

THE COURT: Where—

MR. WINSTEAD: Loss incurred in trade or business.

THE COURT: Where did I have that?

MR. WINSTEAD: It's right at the top of—

MR. NATHAN: —the fifth page.

MR. WINSTEAD: Beginning, "The only issue—"

THE COURT: I don't think it's confusing to the Jury, unless you want a correction to it, I think if we tell them any more they will be more confused than they are right now.

MR. WINSTEAD: I think as long as we have it in the record—

(Discussion off the record.)

THE COURT: Let the record show that counsel called to the Court's attention that the Court erroneously equated loss and transaction for profit with business bad debt. [178] Counsel agreed in view of the remainder of the charge that it is not prejudicial to either of the parties.

MR. NATHAN: We certainly agree to that, your Honor.

THE COURT: Is that correct, Mr. Winstead?

MR. WINSTEAD: Yes.

THE COURT: Other than the reservations you already indicated you would make, are there any other objections?

MR. WINSTEAD: I have one, your Honor, which is to D-12 revised, it's toward the back.

I got the impression when you read it you said,
"Loans by a shareholder to his closely—"

THE COURT: Loans by a shareholder to his closely held corporation generally give rise to non-business bad debts.

MR. WINSTEAD: "This is because an investor as such is not engaged in a trade or business. Where, however, a stockholder who is also an employee of the corporation makes such a loan, the debt is a business bad debt if it is proximately related to the trade or business of being an employee."

Your Honor, I got the feeling when you read that it sounded like you were qualifying the first statement by saying if the stockholder was also an employee it would be a [179] business bad debt, the qualifying phrase comes at the end. When you said it, I got the feeling you were stat-

ing an exception to the general rule would be where the stockholder is also an employee.

I think that might be a little misleading to the Jury.

THE COURT: Well, I will try to correct that, whether there was any possible error on it.

Anything else?

MR. WINSTEAD: That's all I have, your Honor.

MR. NATHAN: That's all I have, your Honor.

(Thereupon, the Jury returns to the courtroom.)

THE COURT: One brief matter, ladies and gentlemen, I would like to re-read one paragraph that I included in my charge and perhaps add a word of explanation with respect to the last sentence of this paragraph.

Loans by a shareholder to his closely held corporation generally give rise to non-business debts. This is because an investor as such is not engaged in a trade or business. Where, however, a stockholder who is also an employee of the corporation makes such a loan—or, as here, executes an indemnity agreement—the debt is a business debt if it is proximately related to the trade or business of being an employee.

Now, that last sentence means this, if a person [180] is both a stockholder and an employee of the corporation and he makes a loan or executes an indemnity agreement or loan is proximately related to his trade or business of being an employee, the debt is a business debt even though he is both a stockholder and an employee, because in that event if the debt is proximately related to his trade or business of being an employee, then it is incurred in connection with that trade or business.

Upon retiring to the jury room, you will select one of your number to act as foreman and, as I told you previously, the foreman will preside over your deliberations and will be your spokesman in Court and will sign your verdict, if you reach one.

The verdict must represent your considered judgment and in order to return a verdict, it is necessary that each juror agree to it.

In other words, your verdict must be unanimous.

Thank you, ladies and gentlemen, you may now retire to the jury room.

(Thereupon, at 5:17 P.M. the Jury retires to begin their deliberations.)

MR. WINSTEAD: I would like the record to reflect that I reiterated my motion for directed verdict both times.

THE COURT: Yes.

[181] MR. WINSTEAD: Defendant first of all excepts the Court's refusal to give its requested instructions Nos. 1 through 17, and in the alternative it's alternative instructions Nos. 14, 14a and 14b.

More specifically, defendant objects to the Court's refusal to charge the Jury that the only sufficient proximate relationship between a taxpayer's trade or business of being an employee in the signing of an indemnity agreement is where the corporation imposes upon the employee the condition to receiving employment that he sign such indemnity agreements and that—or that the signing—he is—strike that.

That he is threatened with the loss of his job and salary if he refuses to sign such agreements.

In addition, the defendant objects to the Court's refusal to charge the Jury that the protection of one's salary must be the dominant motivating factor in signing indemnity agreements. The defendant's position is that it is insufficient if the taxpayer merely shows that it was a significant motivating factor in signing the indemnity agreement.

Defendant further excepts and specifically to the Court's refusal to give defendant's requested instruction No. 15 to the extent that this instruction states that the relationship is insufficient in the event the only relationship within the signing of the indemnity agreement and the [182] securing of the job is that the company will discontinue business if such contracts—indemnity agreements are not signed and, thereby, the company will cease to pay salaries to employees.

Specifically, defendant contends that the Court incorrectly—strike that.

Defendant contends that it was improper for the Court to give its instruction No. 15 in that such instruction is expressly in opposition to that definition of proximate relationship contained in the Worrell case.

Defendant excepts to the Court's charging that in all respects where the significant motivating factor test is used rather than the dominant motivating test.

MR. NATHAN: Plaintiff excepts from failure to use all the plaintiff's requested charges numbered 1 through 18 herein, and in particular failure to give Charge No. 4 which focuses the issue on proximate relationship and whether the agreement was to protect the salary or employee status of Mr. Generes, and sets forth the director's contention.

And the additional charges, but particularly the plaintiff's Charge No. 8, which sets forth that a person can be engaged in more than one trade or business, since it was obvious that the plaintiff taxpayer was involved in more than one trade or business, and this fact should have been advised to the Jury, since there may have been confusion on that [183] point.

Failure to give Charge No. 9, which sets forth the activities required to constitute a trade or business, and the same for Charges 10 and 11.

Particularly the failure to give Charge No. 11, which gives the statutory definition of business bad debt and points out that a person may have more than one trade business and further clarifies that the debt does not have to be directly incurred in the trade or business.

This point was never stressed in the charges, never mentioned in the charges where the test is proximate relationship, and this charge spells out that there is a distinction between directly incurred and proximately related to.

Particularly Charge No. 16, which would have helped explain the proximate relationship and whether the debt is created or acquired in connection with which, of course, is the statutory language.

Plaintiff particularly excepts to Charge No. 17, which has to do with the question of whether the taxpayer could be fired or not and that, under the law and the jurisprudence, this matter is irrelevant and yet it was argued greatly in the trial, that the air should have been cleared by giving requested charge No. 17.

Plaintiff excepts to the failure to give requested [184] Charge No. 18 because although the Court selected the significant motivation test as set forth in Charge No. 18, considering the extreme importance of this test, there should have been an explaining as set forth in Charge 18, that the taxpayer does not have the burden of proving that the sole or the only or the primary motivation was to protect his

trade or business, and this further explanation would have benefited the Jury in understanding the test, which, of course, is extremely important here.

MR. WINSTEAD: Defendant excepts to that part of the charge which lists as a factor for the Jury to consider whether it was a part of Mr. Generes' duties as an officer or employee of Kelly-Generes to secure financing for the corporation and to obtain performance bonds for the company's construction projects on the grounds that this is not an appropriate factor.

(Thereupon, at 7:10 P.M. the Jury returns to the court-room with a question.)

THE COURT: Court will come to order, please. Ladies and gentlemen, the Marshal has handed me a question which I will read aloud and then I will try to answer it.

The question is: "Is the question given to us intended for us to decide whether he signed the indemnity agreement solely for the protection of his salary, investment, [185] or could it be both?"

In human conduct, a person may act with more than one motive for an action. As all of us know from our own actions, we may do something for several reasons, so the test that you are to apply here, and I am going to read back to you part of the charge that I gave you, and I think from this the answer to the question will be clear.

A debt is proximately related to the taxpayer's trade or business, and it is not rendered a non-business debt merely because there was a non-qualifying motivation as well, even though the non-qualifying motivation was the primary one.

Who is the foreman?

MR. CLARK: I am.

THE COURT: Does that answer the question, do you think, sir?

MR. CLARK: Yes and no.

I think for some of us it might. I think I do.

THE COURT: All right.

Let me read that to you again, because I hesitate to elaborate on this charge unless, after you think about my re-reading it, it is still unclear to you, and then if it is still unclear, I will be glad to try to add something to it, but let me read that back again.

[186] The question that you were handed, the special in-

terrogatory, relates to the taxpayer's motivation, what his purpose was in incurring or creating this debt and, as I have charged you, the test that you are to apply is whether the debt was proximately related to his trade or business.

A debt is proximately related to the taxpayer's trade or business when its creation was significantly motivated by the taxpayer's trade or business, and it is not rendered a non-business debt merely because there was a non-qualifying motivation was the primary one.

If after thinking about that there is a further question in the Jury's mind, let me know, I will be glad to see if I can answer it further.

(Thereupon, at 7:14 PM the Jury retires to deliberate further.)

(Thereupon, at 7:55 P.M. the Jury returns to the court-room with another question.)

THE COURT: Ladies and gentlemen of the Jury, the question you have asked me is: "Would you please re-read your answer to our question, and possibly interpret it further?"

Thank you."

I will read the answer that I gave you previously and then I will give you a little further interpretation.

[187] A debt is proximately related to the taxpayer's trade or business when its creation was significantly motivated by the taxpayer's trade or business, and it is not rendered a non-business debt merely because there was a non-qualifying motivation as well even though the non-qualifying motivation was the primary one.

A person may have more than one reason or motivation for his actions.

In order to prevail here, the taxpayer must prove by a preponderance of the evidence that the creation of the debt or the execution of the indemnity agreement, out of which the debt arose, was significantly motivated by his trade or business of being an employee working for a salary, but if he does this, he need not prove that this was the only motive or even that it was his primary motive.

He does bear the burden of proving by a preponderance of the evidence, however, that in signing the indemnity agreement he was significantly motivated by a desire to protect his job and salary as distinguished from a desire to protect his investment or enhance its value.

Do you think that answers it, Mr. Foreman?

MR. CLARK: I hope so.

THE COURT: If it doesn't, don't hesitate to come back, we'll be here.

(Thereupon, the Jury retires to deliberate further, [188] after which time they returned to the courtroom.)

THE COURT: Mr. Clark, you have handed to me a verdict.

As Foreman of the Jury, does this represent the verdict, reached by the Jury?

MR. CLARK: Yes.

THE COURT: Would the Clerk read the verdict, please?

THE CLERK: Civil Action 16156, Edna Generes, wife of and Allen H. Generes versus the United States of America. Special verdict.

"We, the Jury in the above matter, unanimously find as follows:

Interrogatory:

Do you find from a preponderance of the evidence that the signing of the blanket indemnity agreement by Mr. Generes was proximately related to his trade or business of being an employee of the Kelly-Generes Construction Company?

Yes.

New Orleans, Louisiana, this 24th day of August, 1967.

Signed, Wesley C. Clark, Foreman of the Jury."

Ladies and gentlemen of the Jury, was that your verdict?

THE JURORS: Yes.

[189] THE COURT: Does the plaintiff desire the Jury polled?

MR. NATHAN: No, your Honor.

THE COURT: Does the defendant desire the Jury polled?

MR. WINSTEAD: No.

THE COURT: Ladies and gentlemen, I want to thank you for the long, hard day you have put in.

I know that you have been very thorough in your deliberations on the matter put before you.

I think we all owe you a debt of thanks for your service as citizens.

The Court orders that the verdict be recorded and made the judgment of the Court.

The Jury is now discharged.

(Whereupon, at 8:05 P.M. Court was adjourned.)

[190]

REPORTER'S CERTIFICATE

The undersigned certifies, in his capacity of Official Court Reporter for the United States District Court, Eastern District of Louisiana, the foregoing to be a true and correct transcription of his Stenograph notes taken during the proceedings in the courtroom, 400 Royal Street, on August 24, 1967.

New Orleans, Louisiana, this 6th day of November, 1967.

(Signed) GARY JON DAVIS

Gary Jon Davis

Official Court Reporter

United States District Court

MOTION FOR DIRECTED VERDICT BY PLAINTIFFS, EDNA GENERES,
WIFE OF AND ALLEN H. GENERES, AT THE CLOSE
OF ALL EVIDENCE.

(Number and Title Omitted)

Filed : Aug. 24, 1967

Plaintiffs, Edna Generes, wife of and Allen H. Generes, pursuant to Rule 50 (a), F.R.C.P., move the Court to direct a verdict in their favor in this action in the following respects, to-wit:

I

In their favor against defendant upon the following grounds:

1. The evidence requires a finding that Allen H. Generes was engaged in a trade or business of rendering services for pay as a corporate officer of Kelly-Generes Construction Company, Inc.
2. The evidence requires a finding that a significant motive of taxpayer in executing the continuing indemnity agreement was in connection with or proximately related to his business of being a salaried employee.
3. The evidence requires a finding that the execution of the "blanket indemnity agreement" arose in connection with and was proximately related to the trade or business of Allen H. Generes of rendering services for pay as a corporate officer of Kelly-Generes Construction Co., Inc.
4. The evidence requires a finding that the desire to preserve his employment and salary as an officer and employee of Kelly-Generes Construction Co., Inc., was a significant motive of Allen H. Generes in executing the "blanket indemnity agreement."
5. Alternatively, the evidence requires a finding that the taxpayer has shown that his dominant motive in executing the indemnity agreement was in connection with and proximately related to his business of being a salaried employee, rather than to his status as an investor in the corporation.
6. The evidence does not warrant a finding that the dominant motive of taxpayer in executing the indemnity agreement was in connection with his status as an investor

in the corporation rather than to his status as a salaried employee.

7. The evidence in this case does not warrant a finding that the signing of a blanket indemnity agreement by taxpayer was not proximately related to his trade or business of being an employee of Kelly-Generes Construction Company.

8. Alternatively, the evidence in this case does not warrant a finding that the signing of the blanket indemnity agreement by Mr. Generes was not directly related to his trade or business of being an employee of Kelly-Generes Construction Company.

Sessions, Fishman, Rosenson,
Snellings and Boisfontaine

MAX NATHAN, JR.

(Trial Attorney)

1333 National Bank of Commerce
Bldg.

New Orleans, Louisiana 70112
522-9512

(Signed) **Max Nathan, Jr.**

MAX NATHAN, JR.

Attorney for Plaintiff

Edna Generes, wife of and
Allen H. Generes

PLAINTIFFS' REQUESTED CHARGE No. 1

The Plaintiffs in this case, Allen H. Generes and his wife, Edna Generes, are husband and wife who live in New Orleans, Louisiana. Mrs. Generes is joined as a Plaintiff in this lawsuit simply because she is the wife of Allen Generes and filed joint income tax returns with her husband for the tax years that are in question (and a separate return for one year). She is not actually involved as a party except because of her status as Allen Generes' wife. Thus, I will charge you and will speak of "the Taxpayer", and by this I refer to Allen Generes and it is understood that whatever is determined with regard to Allen Generes will also apply to his wife.

The Plaintiff Taxpayer, Allen Generes, seeks recovery of income taxes amounting to \$43,851.46, plus interest, which he asserts to have been wrongfully collected from him and from his wife for three calendar years, 1959, 1960 and 1961. He alleges that the Commissioner of Internal Revenue erroneously disallowed his claimed deduction of \$162,104.57 in the year 1962 as a business bad debt, which resulted in a net operating loss for 1962 which he carried back to 1959, 1960 and 1961. You are not concerned with the mechanics of the operation of the net operating loss. If the deduction claimed is found by you to be properly claimed as a business bad debt, then the Plaintiff Taxpayer is entitled to a net operating loss by operation of law.

PLAINTIFFS' REQUESTED CHARGE No. 2

The Plaintiff Taxpayer, Allen H. Generes, asserts that the claimed business bad debt deduction arises from the following facts: That for many years prior to and during the year 1962, he was an officer and employee of Kelly-Generes Construction Company, Inc. Kelly-Generes Construction Company was a general contractor, whose business required that for many of the construction contracts that it obtained, it had to obtain payment and performance bonds of a bonding company guaranteeing that Kelly-Generes would perform the job and would pay all laborers and materialmen. A construction business of this nature cannot operate without the use of bonds. The Taxpayer, Allen H.

Generes, contends that in his position with the company, as one of its officers and for which he received a salary of \$12,000 per year, his job was to obtain the bonding credit needed by the company to perform the jobs on which it bid. In order to obtain this credit, so he contends, he was required to sign an indemnity agreement with Maryland Casualty Company, a bonding company, agreeing to hold them harmless on any losses that Maryland might suffer as the result of bonding construction operations for Kelly-Generes Construction Company. Maryland Casualty Company refused to execute bonds for construction contracts of Kelly-Generes unless Allen H. Generes, the president, and William F. Kelly, the vice-president, personally signed a continuing indemnity agreement, by which they would be personally liable to Maryland Casualty for any losses that it might suffer.

The Taxpayer contends that this indemnity bond which he signed, making himself personally liable to the bonding company, was directly and proximately related to his business as an officer of Kelly-Generes Construction Company, Inc. He contends that the indemnity bond was essential to the operation of the company's business. Without such indemnity, so he says, the bonding companies would not issue their bonds, and in that case the company could not carry on its business or obtain new business, and he, as an officer, would lose his job because the corporation could not do business.

PLAINTIFFS' REQUESTED CHARGE No. 3

The Taxpayer, Allen H. Generes, claimed the payment of \$162,104.57 as a business bad debt deduction for the year 1962. The deduction resulted in a net operating loss in 1962, which under federal tax law can be carried back for three years to readjust his income tax for those years (Section 172 of the Internal Revenue Code). Allen Generes claimed the three year carryback, and was automatically paid the refund he claimed, but then, upon examination, the Internal Revenue Service disagreed with Allen H. Generes' interpretation of the circumstances, determined that the 1962 claim was not properly, so it said, a business bad debt, and disallowed the net operating loss carryback for the three years.

The Revenue Service made appropriate adjustments and assessed Allen H. Generes for the years 1959, 1960 and 1961, resulting in a claimed tax deficiency of \$43,851.46. Allen Generes paid this amount under protest, with interest of \$6,283.03, making a total payment of \$50,134.49. He then filed a claim for refund for the years 1959, 1960 and 1961, which the Internal Revenue Service disallowed. This lawsuit was filed by the Taxpayer for refund of the amount paid under protest.

Allen H. Generes contends that the payment he made to Maryland Casualty Company is a business bad debt, which I will explain to you in my charges later, and alternatively he claims that this is a loss incurred in his trade or business. The significance of these terms will be explained to you later, but at this point it suffices to say that the taxpayer claims that the execution of the indemnity agreement, and consequently the expenditure he made, were proximately related to a trade or business in which he was engaged. He further claims that his dominant motive in executing the indemnity agreement was to protect his salary as an officer and employee of Kelly-Generes Construction Company. In the event that you find that either one of these contentions is correct, then Allen Generes is entitled to the refund he claims. If you find that neither of these contentions is correct, then he is not entitled to the refund.

PLAINTIFFS' REQUESTED CHARGE No. 4

As a defense to Plaintiff's claim, the Defendant Director of Internal Revenue contends that the expenditure of \$162,104.57 in 1962 constituted a non-business expenditure, either as a non-business bad debt, or as a loss in a transaction entered into for profit. If the Director's contention is correct, then the expenditure would not be available for a net operating loss carryback to the years 1959, 1960 and 1961, and Taxpayers would not be entitled to the refunds of taxes and interest that they claim.

To be more specific, the Director contends that the execution of the indemnity agreement and the consequent expenditure of \$162,104.57 made by Mr. Generes were not proximately related to any trade or business in which Mr. Generes was engaged, and the loss was not "created or acquired . . . in connection with" any such business. The

Director contends that the execution of the indemnity agreement was not to protect the salary or the employee status of Mr. Generes, but was the result of Mr. Generes' status as a mere investor in Kelly-Generes Construction Company, Inc.

PLAINTIFFS' REQUESTED CHARGE No. 5

The issues before you, which I will outline in detail later, may be boiled down as follows: Primarily, you must determine whether the payment by Allen H. Generes to Maryland Casualty Company constituted a business expenditure or a non-business expenditure. This will involve some complicated questions, and specific interrogatories will be submitted to you to answer. Specifically, you will have to determine whether the obligation that Allen H. Generes had under the "blanket indemnity agreement" he signed with Maryland gave rise to a business bad debt or a non-business bad debt when he was compelled to pay Maryland \$162,104.57 in 1962 because of the agreement.

You may determine that the agreement did not give rise to a bad debt, whether business or non-business, and in that event, you must decide whether the payment was a loss incurred in Allen H. Generes' trade or business, or whether it was a loss incurred in a transaction entered into for profit.

Articles 8-9, Pre-Trial Order.

PLAINTIFFS' REQUESTED CHARGE No. 6

The parties agree that:

In the normal conduct of its business, Kelly-Generes Construction Co., Inc., performed many individual jobs on which performance bonds and payment bonds were executed with Maryland Casualty Company and other surety companies acting as sureties.

In the course of conducting the business of Kelly-Generes Construction Co., Inc., an instrument entitled "Blanket Indemnity Agreement" with Maryland Casualty Company was executed on December 3, 1958, executed by the corporation as applicant, through Allen H. Generes, its President, and the indemnity agreement was signed individually by Allen H. Generes and William F. Kelly, as indemnitors,

agreeing to reimburse Maryland for any losses it might suffer.

In 1962 as the result of that indemnity agreement, Allen H. Generes paid Maryland Casualty Company the sum of \$162,104.57 to reimburse Maryland Casualty Company for losses it sustained by virtue of bonds it had written for Kelly-Generes Construction Co., Inc.

It is not disputed, then, that Allen H. Generes was legally obligated to pay Maryland Casualty Company for the losses that Maryland Casualty Company sustained. Furthermore, it is not disputed that when Allen Generes paid Maryland Casualty Company, he became subrogated to the rights of Maryland Casualty Company against Kelly-Generes Construction Company, Inc., which was then a defunct corporation. You do not need to worry about the right of subrogation; this merely means that Maryland had a right to recover from Kelly-Generes Construction Company the money it spent, and when Allen Generes paid off Maryland, he stood in Maryland's shoes and had the same right to recover from Kelly-Generes. Since the corporation was defunct, this meant that the right Allen Generes had against the corporation, Kelly-Generes, was worthless. This would be a bad debt. The issue for you to decide is whether *that* bad debt is a business bad debt or a non-business bad debt.

The Director contends that the bad debt was not proximately related to Mr. Generes' trade or business and was not created or acquired in connection with his business.

Mr. Generes contends that he was an officer of Kelly-Generes Construction Company, receiving a salary of \$12,000.00 a year; that Kelly-Generes as a construction company required payment and performance bonds in order to obtain contracts, that it could not operate unless it had such bonds; that the bonding company would not write the bonds unless Allen Generes agreed personally to indemnify Maryland for any losses it would sustain. Consequently, Generes contends that he executed the indemnity agreement for the purpose of protecting his salary as an officer and employee of Kelly-Generes and claims that this is directly and proximately related to his trade or business of rendering services for pay as an officer of the corporation.

Stipulations No. 7, 8 and 9, Pre-Trial Order,
La. Civil Code, Articles 1757, 1760 and 2161.

PLAINTIFFS' REQUESTED CHARGE No. 7

The question whether this debt is a business debt is a question of fact for you to decide. The character of the debt, as business or non-business, must be determined by you as finders of the facts, basing your determination upon your opinion as to whether the loss is proximately related to the conduct of a trade or business in which the taxpayer is engaged.

Fed. Tax Regs., § 1.166-5(b)(2).

PLAINTIFFS' REQUESTED CHARGE No. 8

A business is that which ordinarily occupies the time, attention and labor of men for the purpose of making a living or making a profit.

A person can, of course, be engaged in more than one trade or business.

Bouvier's Law Dictionary.

See *Flint vs. Stone Tracy Co.*,
220 U.S. 107 (1910)

IRC § 166

Snyder v. Commissioner,
295 U.S. 134,
55 S. Ct. 737 (1935)

Washburn v. Commissioner,
51 F. 2d 949 (8 Cir., 1931)

Roberts v. Commissioner,
258 F. 2d 634
(5 Cir., 1958)

PLAINTIFFS' REQUESTED CHARGE No. 9

The test whether the activities of the taxpayer constitute a trade or business is whether the activities are entered into and carried on in good faith and for the purpose of making a profit, or in other words, that the activity is not conducted merely for pleasure, exhibition or social diversion.

To constitute a person's trade or business, the person

must be engaged in a legitimate enterprise, investing time and capital on the future outcome of the enterprise.

Doggett v. Burnett,
65 F. 2d 191, 194 (1933)

PLAINTIFFS' REQUESTED CHARGE No. 10

The term "trade or business" includes any trade or business activity of any kind, and the term refers to any particular occupation or employment engaged in for gain. It is an occupation a person has learned, an activity or activities in which he engages for profit.

Webster's New International Dictionary
Black's Law Dictionary

PLAINTIFFS' REQUESTED CHARGE No. 11

The law defines a "business bad debt" as a debt that is "created or acquired (as the case may be) in connection with a trade or business of the taxpayer." The law says "a" trade or business, so that if the taxpayer has more than one trade or business, the debt can be created or acquired in connection with any one of the taxpayer's trades or businesses.

And the debt does not have to be *directly* incurred in the trade or business. It is sufficient if the activity giving rise to the debt is essential to one of those trades or businesses, is proximately related to it, so that it can be said to have been incurred "in connection with" that trade or business.

U.S. v. Keeler,
308 F. 2d 424 (9 Cir. 1962)

IRC § 166

Fed. Tax Règs. § 1.66-5(b)(2)

PLAINTIFFS' REQUESTED CHARGE No. 12

You are instructed that, as a matter of law, a person may have as a trade or business the rendering of services for pay. An officer of a corporation who receives a salary as such is considered in the eyes of the law to be engaged in a trade or business—the trade or business of rendering services for pay.

Thus I instruct you that, as a matter of law you must find that Allen H. Generes was engaged in a trade or business as a corporate officer of Kelly-Generes Construction Company, the trade or business of rendering services for pay.

Philip W. Fitzpatrick v. Commissioner,
TC Memo. 1967-1, CCH Dec. 28, 299 (M),
Docket No. 5309-64, decided Jan. 5, 1967

Weddle v. Commissioner,
325 F 2d 493,
(2 Cir., 1963)

Trent v. Commissioner,
291 F. 2d 669
(2 Cir., 1961)

Roberts v. Commissioner,
258 F. 2d 634
(5 Cir., 1958)

PLAINTIFFS' REQUESTED CHARGE NO. 13

The federal tax law permits an individual to deduct losses incurred in a trade or business as well as bad debts which are created or acquired in connection with a trade or business of the taxpayer. These are two separate categories but they are obviously closely related and overlap in many respects. All bad debts represent losses or they would not be "bad". The essential element in both is the business relationship. And the determination of whether the loss, or the debt, has been incurred in a trade or business is made in substantially the same manner. In both cases, the character of the debt or the character of the loss is determined by the relation the loss or the debt bears to a trade or business of the taxpayer.

The tax consequences to Mr. Generes are the same, whether you find that this is a business bad debt or a loss incurred in a trade or business. But because of the technical wording of the tax statutes, I will charge you separately on the two categories.

Mr. Generes claims that the deduction is proper as a business bad debt; the Director contends that it is a non-business bad debt.

In the alternative, Mr. Generes contends that the loss was

incurred in a trade or business; the Director contends that the loss was incurred in a transaction entered into for profit unrelated to a trade or business of the taxpayer.

IRC § 165

IRC § 166

Fed. Tax Regs: 1.166-5(b)

PLAINTIFFS' REQUESTED CHARGE No. 14

The loss sustained by an individual taxpayer in discharge of his obligation as a guarantor of a corporate obligation shall be treated as a bad debt for income tax purposes. It shall be considered a "business" bad debt if the guaranty was proximately related to a trade or business of the taxpayer so that it can be said that the debt was created or acquired in connection with a trade or business of the taxpayer.

Thus, in the circumstances of this case, I instruct you that you shall find that the payment by Allen H. Generes in 1962 gave rise to a business bad debt if in your opinion the execution of the continuing indemnity agreement was proximately related to Allen H. Generes' trade or business as a corporate officer of Kelly-Generes Construction Company.

Fed. Tax Regs., § 1.166-8(b)

PLAINTIFFS' REQUESTED CHARGE No. 15

Mr. Generes contends that his trade or business was working as a corporate executive of Kelly-Generes Construction Company, Inc., for which he received a salary of \$12,000.00 a year. I have instructed you that you must find this to be correct as a matter of law. Mr. Generes contends that in order to obtain bonds without which the company could not operate it was a necessity of that trade or business that he agree to be liable in the event the bonding company had to fulfill its bonding promise and in the event that Kelly-Generes could not indemnify the bonding company.

This is a question of fact for you to determine.

PLAINTIFFS' REQUESTED CHARGE No. 16

A debt is created or acquired in connection with a taxpayer's trade or business so as to be a business bad debt if

the debt, or the activity giving rise to the debt, was such that without the taxpayer assuming or acquiring it his trade or business would no longer be able to operate in the manner in which it is intended to operate.

Weddle v. Commissioner,
325 F. 2d 849
(2 Cir., 1963)

Trent v. Commissioner,
291 F. 2d 669
(2 Cir., 1961)

Worrell v. U.S.A., U.S.D.C., So. Dist. Ga.
Civil Action No. 1422, decided
April 6, 1967 (see 1967 CCH US Tax
Cases, E 9401, p. 84,098)

PLAINTIFFS' REQUESTED CHARGE No. 17

A loss or debt may be "in connection with a taxpayer's trade or business" if the activity giving rise to the debt was necessary for a taxpayer to maintain his employment. The mere fact that the taxpayer was a shareholder in the company and thus could not be "fired" is not controlling. It is no job "working for a company that has no work."

The fact that Allen H. Generes did not have to fear being fired by a superior is not at all conclusive as to what he was trying to protect. He would have been "fired" soon enough if the company, Kelly-Generes Construction Co., Inc., had to cease operations through inability to obtain bonds.

As I have instructed you, it is a matter of law that losses or debts incurred in protecting one's position as an employee are losses or debts incurred in a trade or business.

Weddle v. CIR,
325 F. 2d 849,
(2 Cir., 1963)

Whipple v. Commissioner,
373 U.S. 193 ().

Trent v. Commissioner,
291 F. 2d 669
(2 Cir., 1961)

Worrell v. U.S.A.
U.S.D.C., So. Dist. Ga.,
Civil Action No. 1422, decided
April 6, 1967 (see 1967 CCH
U.S. Tax Cases, P 9401, p. 84,098)

PLAINTIFFS' REQUESTED CHARGE No. 18

A person may have more than one reason or motivation for his actions. The taxpayer here does not have the burden of proving that his sole or only, or even his "primary" motivation for executing the indemnity agreement (as a result of which he paid Maryland Casualty Company \$162,104.57) was to protect his trade or business of corporate employment in order for him to be entitled to the business bad debt deduction.

It suffices for the taxpayer to show that the creation of the debt (here, the execution of the indemnity agreement), was "significantly" motivated by his trade or business, even though there may have been other motivations as well.

In other words, to obtain a business bad debt deduction, which the taxpayer here claims, the taxpayer need only show that the creation of the debt was "significantly" rather than "primarily" motivated by his trade or business interest.

Weddle v. Commissioner,
325 F. 2d 849
(2 Cir., 1963)

IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF LOUISIANA
NEW ORLEANS DIVISION

EDNA GENERES, wife of and
ALLEN H. GENERES,

Plaintiffs

v.

UNITED STATES OF AMERICA,
Defendant

CIVIL NO. 16156
SECTION "C"

DEFENDANT'S REQUESTED JURY INSTRUCTIONS

Pursuant to Rule 51 of the Federal Rules of Civil Procedure, the defendant respectfully requests and moves the Court to instruct the jury by giving the following instructions, numbered 1 through 17, attached hereto, and advise counsel prior to argument as to which of these instructions will be given and which will be refused.

Respectfully submitted,

PETER WINSTEAD
*Attorney, Tax Division,
Department of Justice,
7A06 Federal Building,
Fort Worth, Texas 76102.
Attorney for Defendant*

DEFENDANT'S REQUESTED INSTRUCTION No. 1

Ladies and gentlemen of the jury:

Now that you have heard the evidence and the arguments of counsel, the Court will instruct you as to the governing law in this case.

Although you are the sole judges of the facts, you are duty bound to follow the law given in the Court's instructions and to apply that law to the facts as you may find them from the evidence. You are not to be concerned with the wisdom of any rule of law, for regardless of any opinion you may have as to what the law should be, it would be a violation of your sworn duty to follow any other view of the law than that given in the Court's instructions. The fact that the plaintiffs are private individuals and the defendant is the United States, should not enter into or affect your verdict. The plaintiffs and the defendant are equal before the law, and each should be given the same fair and equal treatment by you. You are to decide the case solely and exclusively upon the evidence, except that you should be guided at all times in your deliberations by the law as the Court gives it to you.

Given —————

Refused —————

DEFENDANT'S REQUESTED INSTRUCTION No. 2

The evidence consists of sworn testimony of the witnesses, all exhibits which have been received in evidence, all facts which have been admitted or stipulated, and all applicable presumptions stated in these instructions. Any evidence as to which an objection was sustained by the Court, and any evidence ordered stricken by the Court, must be entirely disregarded. The statements and arguments of counsel are not evidence.

You are to consider only the evidence, but in your consideration of the evidence, you are not limited to the statements of the witnesses. On the contrary, you are permitted to draw from the facts, which you find have been proved, such reasonable inferences as seem justified in the light of your own experience. You, as jurors, are the sole judges of the credibility of the witnesses and the weight their testimony deserves. A witness is presumed to speak the truth.

But this presumption may be outweighed by the manner in which the witness testifies, the character of the testimony given, or by contradictory evidence. You should carefully scrutinize the testimony given, the circumstances under which each witness has testified, and every matter in evidence which tends to indicate whether the witness is worthy of belief. Consider each witness' intelligence, motives and state of mind, and demeanor and manner while on the stand. Consider also, any relation each witness may bear to either side of the case, the manner in which each witness may be affected by the verdict, and the extent to which, if at all, the witness' testimony is either supported or contradicted by other evidence.

Given _____

Refused _____

DEFENDANT'S REQUESTED INSTRUCTION No. 3

It is the duty of the attorneys on each side of the case to object when the other side offers testimony or other evidence which counsel believes is not properly admissible.

When the Court has sustained an objection to a question, the jury is to disregard the question and may draw no inference from the wording of it or speculate as to what the witness would have said if permitted to answer.

Upon allowing testimony or other evidence to be introduced over the objection of counsel, the Court does not, unless expressly stated, indicate any opinion as to the weight or effect of such evidence. As stated before, the jurors are the sole judges of the credibility of all witnesses and the weight and effect of all evidence.

Given _____

Refused _____

DEFENDANT'S REQUESTED INSTRUCTION No. 4

There is one issue presented for decision in this case. Your verdict will be in the form of an answer to a special question which will be submitted to you, rather than a general verdict for the plaintiffs or the defendant. I will now proceed to instruct you as to the law applicable to that question.

Your answer to that special question must be unanimous. Your foreman, whom you will select upon retiring to the

jury room, and who will preside over your deliberations and act as your spokesman in Court, will place your answer in the space provided below the question.

It is proper to add the caution that nothing said in these instructions, nothing in any form of verdict prepared for your convenience, is to suggest or convey in any manner or way any indication as to what verdict I think you should find. What the verdict shall be is the sole and exclusive duty and responsibility of the jury.

It is your duty, as jurors, to consult with one another and to deliberate with a view to reaching an agreement, if you can do so without violence to individual judgment. Each of you must decide the case by yourself, but do so only after an impartial consideration of the evidence with your fellow jurors. In the course of your deliberations, do not hesitate to reexamine your own views and change your opinion if convinced it is erroneous. But do not surrender your honest convictions as to the weight or effect of evidence solely because of the opinion of your fellow jurors, or for the mere purpose of returning a verdict.

Given —

Refused —

DEFENDANT'S REQUESTED INSTRUCTION No. 5

Members of the jury, this is a lawsuit against the United States under the federal income tax statutes passed by Congress wherein the plaintiffs, Edna and Allen H. Generes, seek a refund of income taxes in the approximate amount of \$50,134.49. This means that the Commissioner of Internal Revenue levied an additional assessment of taxes against the plaintiffs for the years 1959, 1960, and 1961; that subsequently the plaintiffs made full payment of the amount required to be paid by the assessment, that the plaintiffs filed claims for refund for these taxes and the Internal Revenue Service denied these claims for refund; and now the plaintiffs sue for a refund of the additional taxes which they paid.

This is not an action instituted by the Government, but rather one instituted by the plaintiffs against the Government. In short, the plaintiffs have paid all the income taxes which the Government says they owe, and they now seek to recover a portion of those taxes which they say the Government has wrongfully retained or refused to refund.

I also wish to stress very *strongly* that this is *not* a *criminal* matter. Neither Mr. or Mrs. Generes will be sent to prison, fined, or otherwise punished, regardless of the outcome of this lawsuit. This is a *civil* action that involves only a difference of opinion between the plaintiffs and the Government over the appropriate tax treatment of certain deductions for a worthless debt claimed by the plaintiffs. The Government has not accused Mr. or Mrs. Generes of tax evasion of any kind.

Given _____

Refused _____

DEFENDANT'S REQUESTED INSTRUCTION No. 6

The only issue in this case is whether the payment in 1962 of \$162,104.57 to Maryland Casualty Company by the plaintiff, Allen H. Generes, gave rise to a business bad debt deduction or a nonbusiness bad debt deduction. Mr. Generes paid this money to Maryland Casualty Company pursuant to his obligation under the blanket indemnity agreement of December 3, 1958. Upon his payment of this amount, Mr. Generes under Louisiana law became subrogated to the right of Maryland Casualty Company against Kelly-Generes Construction Co. This means he became a creditor of Kelly-Generes Construction Co. He was unable to collect this debt from the company and this has given rise to the bad debt deduction involved in this controversy. The Government has *not* denied a deduction to plaintiffs for this payment, but rather has allowed it as a deduction for the worthlessness of a *nonbusiness* bad debt in the year 1962. The plaintiffs contend that the deduction should have been allowed as a *business* bad debt. The significance of characterizing the bad debt as a business bad debt rather than as a nonbusiness bad debt is that only *business* bad debts are available for a tax advantage known as a net operating loss carryback. You need not be concerned with this, but suffice it to say that it enables taxpayers, such as Mr. and Mrs. Generes, to take unused business deductions from one year, here 1962, and transfer them to other years, namely, 1959, 1960, and 1961, in order to obtain the benefit of the deduction in prior years and a refund of taxes paid in prior years. This explains why the payment involved in this action occurred in 1962 and the taxes involved in this controversy relate to the years 1959, 1960, and 1961.

The only question which you must decide is whether the bad debt involved should be characterized as a business bad debt or as a nonbusiness bad debt. The plaintiffs contend that a business bad debt is involved. The defendant contends that a nonbusiness bad debt is involved.

Given _____

Refused _____

DEFENDANT'S REQUESTED INSTRUCTION No. 7

It is my duty to instruct you on the appropriate law concerning the differences between business and nonbusiness bad debts for income tax purposes. Again, may I remind you that your views as to what the law should or should not be in this area are irrelevant, and as jurors, you are bound to apply the law as I state it to be.

The internal revenue laws divide bad debts generally into two classes, nonbusiness bad debts and business bad debts. Nonbusiness bad debts are all those debts which are *not* either created or acquired in connection with a trade or business of the taxpayer or the loss from the worthlessness of which is incurred in the taxpayer's trade or business. The only problem before you is whether the bad debt here involved, namely, the obligation of the plaintiff, Mr. Allen H. Generes, to indemnify Maryland Casualty Company was created, acquired, or incurred in a trade or business of Mr. Generes.

Section 166, Internal Revenue Code of 1954
(26 U.S.C., Sec. 166)

Given _____

Refused _____

DEFENDANT'S REQUESTED INSTRUCTION No. 8

Judicial interpretations of the bad debt provisions provide us with more specific and understandable rules in determining what constitutes business as opposed to non-business bad debts.

First, you should not consider the term "nonbusiness" as referring only to debts between friends or members of a family. "Nonbusiness" does not mean the absence of a desire to make a profit from loaning money, guaranteeing the loans of others, signing indemnity agreements. The term refers to many debts between unrelated persons or

between persons attempting to make a profit by reason of loaning money, guaranteeing the loans of others, or signing indemnity agreements. In short, the term "nonbusiness" does not mean that no valid debt or obligation exists; it does not mean that the debtor and creditor did not deal at arm's length; it does not mean the lender, guarantor, or indemnitor did not want to earn money from his activities. The non-business bad debt provisions were designed to allow full deductibility of a bad debt only where the debt has a direct connection with activities which the tax laws recognize as a trade or business, and every income or profit-making activity is not a trade or business.

Whipple v. Commissioner, 373 U.S. 193.

Given —

Refused —

DEFENDANT'S REQUESTED INSTRUCTION No. 9

Under the applicable provisions of the internal revenue laws, in order for a bad debt to be deductible from the plaintiff's income as a business bad debt, it must first be shown that the plaintiff is regularly engaged in a trade or business and secondly that the debt arose directly in connection with that trade or business. Stated otherwise, there are *two* requirements for a business bad debt deduction. First, the *activities* of the plaintiff, with respect to the corporation on whose behalf he signed the indemnity agreement, at the time he entered into the indemnity agreement must constitute the carrying on of a trade or business within the meaning of the tax laws.

Secondly, his entering into this indemnity agreement, must have been directly or proximately related to those particular activities of the plaintiff which are considered *his* trade or business.

An example might better demonstrate the existence of the two requirements for a business bad debt. Assume that I am in the business of buying and selling used cars, and that I make two loans, one to a customer to whom I agree to extend credit on the purchase of a used car, the second to another individual to enable him to buy a new car from a new car dealer. Assume that both debts become uncollectible in the same year. While I am admittedly in the business of buying and selling used cars, only the first debt is deductible as a business bad debt, since it alone was directly related

to my trade or business of attempting to make a profit on the sale of used automobiles. The second is a nonbusiness bad debt, since loaning money to someone to purchase a new automobile from another automobile dealer has no relationship to my business of selling used automobiles. While the second debt was a valid and enforceable obligation, with a complete stranger, and from which I hoped to make a profit, it is nevertheless a nonbusiness bad debt.

Unless both requirements are met, the plaintiffs are not entitled to a business bad debt deduction. In short, while it may be undisputed that the activities of Mr. Generes at the time he became obligated to indemnify the Maryland Casualty Company constituted a trade or business, the plaintiffs are not entitled to prevail unless they also show that the obligation to indemnify was directly or proximately related to that trade or business.

United States v. Byck, 325 F. 2d 551 (C.A. 5th)

Kelly v. Patterson, 331 F. 2d 753 (C.A. 5th)

Given —

Refused —

DEFENDANT'S REQUESTED INSTRUCTION No. 10

The first requirement is that the activities of the plaintiff, Mr. Allen H. Generes, as an officer, director, and employee of Kelly-Generes Construction Co. must constitute a trade or business.

At this point, I must caution you that there is a distinction to be drawn between the business of the corporation, Kelly-Generes Construction Co., and the business of Allen H. Generes, individually. The corporation is in the construction business and Mr. Generes was employed by and owned stock in that corporation. This does not mean that Mr. Generes was in the construction business. The only trade or business which Mr. Generes could conceivably be in is that of an employee rendering services to the corporation for pay.

The courts have told us that devoting one's time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the persons so engaged. Though such activities may produce income, profit or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of

investing and is generated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself.

Whipple v. Commissioner, supra.

Given _____

Refused _____

DEFENDANT'S REQUESTED INSTRUCTION No. 11

As I mentioned previously, the plaintiffs must satisfy two requirements in order to obtain a business bad debt deduction. The first, that Mr. Generes' activities must constitute a trade or business separate and apart from that of the Kelly-Generes Construction Co., has already been discussed. You may assume that Mr. Generes was in the trade or business of rendering services for pay as an employee of the corporation. The question for you to decide is whether Mr. Generes' signing of the indemnity agreement with Maryland Casualty Company was directly related to that trade or business of being an employee. While being an employee of a company may, in some situations, constitute a trade or business, not every act or deed of an employee is related to his capacity or status as an employee.

For example, I might be an employee of Sears Roebuck Co., but this does not mean that when I purchase stock in that company I am performing an act which is related to my employment with Sears Roebuck Co. On the contrary, I am an investor in the company, and as such, the act of purchasing stock has no direct or proximate relationship with my trade or business of being an employee.

In the present case, you must decide whether Mr. Generes' signing of the indemnity agreement with Maryland Casualty Company was directly related to his trade or business of being an employee of Kelly-Generes Construction Co. or whether the signing of the indemnity agreement was related to his capacity as an investor in this company.

United States v. Byck, supra.

Given _____

Refused _____

DEFENDANT'S REQUESTED INSTRUCTION No. 12

Of course, the important thing for your consideration is what constitutes a sufficiently direct relationship be-

tween the trade or business of being a corporate employee and the act of signing the blanket indemnity agreement, such that the bad debt resulting therefrom should be considered a business bad debt.

The law in this regard has imposed a very strict definition as to what acts of an employee are so directly or proximately related to his trade or business to qualify for business bad debt deductions.

First, it is generally true that where the employee is a controlling or dominant stockholder of a corporation, such as Mr. Generes, and makes loans to his corporation, guarantees its loans, or enters indemnity agreements on its behalf, the losses arising therefrom are to be considered nonbusiness bad debts. This is true because the law recognizes that, while an employee, as the dominant or controlling stockholder, he is attempting to keep the company going and thereby protect his investment in the company. Thus, his activities are those of an investor which do not qualify as a trade or business. Stated otherwise, the owner of the corporation is loaning money to the corporation or signing indemnity agreements on its behalf in order that the company can do business, earn money, and thus pay dividends on its stock or cause its stock to increase in value. Thus, the stockholder or owner is seeking income or profit from the trade or business of the corporation rather than from any separate or independent trade or business of the stockholder.

Kelly v. Patterson, 331 F. 2d 753 (C.A. 5th)

Whipple v. Commissioner, supra.

Given —

Refused —

DEFENDANT'S REQUESTED INSTRUCTION No. 13

Although the loans, guarantees, or indemnity agreements entered into by a dominant stockholder, who is also an employee, are generally to be regarded as giving rise to nonbusiness bad debts, there is one situation where such activity gives rise to business bad debts. This is where the activity is directly related to his trade or business of being an employee of the corporation, rather than being related to his status or capacity as an investor in the corporation.

The question for you becomes whether Mr. Generes' signing of the blanket indemnity agreement was done in his capacity as the dominant shareholder or investor in Kelly-Generes Construction Co. or in his capacity as an employee of the corporation rendering services for pay.

In this regard, the fact that part of Mr. Generes' duties as an officer and employee of Kelly-Generes Construction Co. was to secure financing for the corporation and to obtain performance bonds for the company's construction projects, does not mean that his loss from signing the indemnity agreement was proximately or directly related to his capacity as an employee of the company. These same activities could well have been undertaken by him in his capacity as an investor in the corporation.

In order for Mr. Generes to prevail, he must demonstrate that the signing of the indemnity agreement was directly related to his capacity as an employee of the company. The only relationship which is sufficiently direct or proximate to the trade or business of being an employee is that act or undertaking by the employee which has as its immediate objective the securing of a continued salary to live on or the continued existence of gainful employment. Unless Mr. Generes shows that the immediate objective in signing the indemnity agreement was to keep his salary from terminating or to prevent unemployment, with the risk of not being able to obtain another job, then the Government is entitled to prevail, because the required direct relationship has not been established.

Kelly v. Patterson, supra.

Whipple v. Commissioner, supra.

Given _____

Refused _____

DEFENDANT'S REQUESTED INSTRUCTION No. 14

In determining whether the signing of the blanket indemnity agreement had as its immediate objective the securing of continued employment and a salary, you are instructed that what motivated Mr. Generes in signing the indemnity agreement is of no importance. In short, what Mr. Generes says was his reason for signing the indemnity agreement should not be considered by you.

What is important, and what you must find, is that the Kelly-Generes Construction Co., his employer, told Mr. Generes that unless he signed indemnity agreements, he would not be hired by the company or later told him that unless he signed the blanket indemnity agreement he would be fired from his job and lose his salary. Unless you find that the company, through its officers, threatened Mr. Generes with the loss of his job and salary if he did not sign the indemnity agreement, then you must find for the defendant.

Kelly v. Patterson, supra.

Trent v. Commissioner, 291 F. 2d 669 (C.A. 2d)

Whipple v. Commissioner, supra.

Given —

Refused —

DEFENDANT'S REQUESTED INSTRUCTION No. 15

It is obvious from the testimony in this case that construction companies such as Kelly-Generes Construction Co. cannot operate without bonding agreements such as provided by Maryland Casualty Company. It is also obvious that companies, such as Maryland Casualty Company, often require individual owners of the bonded companies to execute indemnity agreements such as is involved here, wherein the owners of the bonded company agree to hold harmless from loss the bonding company or Maryland Casualty Company.

It is also clear that without the signing of these indemnity agreements by owners, such as Mr. Generes, bonds could not be obtained for construction jobs, and the company, here Kelly-Generes, could not obtain construction jobs, and would therefore eventually go out of business, and, of course, the employees of the company would lose their jobs and their salaries.

In this sense there is a relationship between the signing of the indemnity agreement by Mr. Generes and the continued existence of his job and salary. However, this relationship is an indirect one and is not so directly or proximately related to his trade or business of being an employee, so as to qualify for business bad debt treatment. If this is the only relationship between the signing of the indemnity

agreement and the protection of Mr. Generes' job and salary, then the Government is entitled to prevail.

Trent v. Commissioner, supra.

Kelly v. Patterson, supra.

Whipple v. Commissioner, supra.

Weddle v. Commissioner, supra.

Given —

Refused —

DEFENDANT'S REQUESTED INSTRUCTION No. 16

Throughout these instructions, I have stated that the plaintiff must prove each of his contentions by a preponderance of the evidence.

To establish by a preponderance of the evidence, means to prove that something is more likely true than not true. In other words, a preponderance of the evidence means such evidence as when considered and compared with that opposed to it, has more convincing force and produces in your minds a belief that what is sought to be proved is more likely true than not true.

Now, where the evidence is equally balanced and you are unable to determine in your minds which way the scale should turn, then, the plaintiff has failed to carry his burden and the Court instructs you that you must find for the Government.

Jury Instructions and Forms—Civil
Civ. 2.01 (modified), 28 F.R.D. 401, 415.

Given —

Refused —

DEFENDANT'S REQUESTED INSTRUCTION No. 17

The issue in this case will be submitted to you in the following manner:

Do you find from a preponderance of the evidence that the signing of the blanket indemnity agreement by Mr. Generes was directly related to his trade or business of being an employee of the Kelly-Generes Construction Co.? Check correct answer: Yes — No —

Given —

Refused —

DEFENDANT'S ALTERNATIVE REQUESTED INSTRUCTION No. 14

You must, in short, determine whether Mr. Generes' dominant motivation in signing the indemnity agreement was to protect his salary and status as an employee or was to protect his investment in the Kelly-Generes Construction Co.

Mr. Generes is entitled to prevail in this case only if he convinces you that the dominant motivating factor for his signing the indemnity agreement was to insure the receiving of his salary from the company. It is insufficient if the protection or insurance of his salary was only a significant secondary motivation for his signing the indemnity agreement. It must have been his dominant or most important reason for signing the indemnity agreement.

On the other hand, if you find that Mr. Generes' dominant motivation in signing the indemnity agreement was to protect his investment in the Kelly-Generes Construction Co., then you must find for the Government, since Mr. Generes has failed to establish the required direct relationship between his trade or business of being an employee and the signing of the indemnity agreement. Included within the meaning of protection of an investment are the desire to see the company prosper, to see the value of one's stock increase in value, to eventually obtain dividends, to see the company continue so that one's children can eventually own the stock, or to insure that the money already invested in the company is not lost because the company is forced to cease operations. To the extent any of these desires or a combination thereof motivated Mr. Generes in signing the indemnity agreement, he was looking to the protection of his investment in the company and was not protecting his salary.

Trent v. Commissioner, supra.

Whipple v. Commissioner, supra.

Weddle v. Commissioner, supra.

Kelly v. Patterson, supra.

Given

Refused

DEFENDANT'S ALTERNATIVE REQUESTED INSTRUCTION No. 14(a)

In determining the purpose or motivation of the plaintiff in signing the indemnity agreement, you may consider acts

as well as words. In other words, the purpose or motivation is to be gathered from all the circumstances of the case, including what the plaintiff did as well as what he said, and you are not bound by the plaintiff's statement as to his purpose.

Here, again, the burden of proof is upon the plaintiff to prove his contentions by a preponderance of the evidence.

Given —

Refused —

**DEFENDANT'S ALTERNATIVE REQUESTED INSTRUCTION
No. 14(b)**

Among the factors which you should consider in determining whether Mr. Generes' motivation was to protect his salary and job or to protect his investment, are the following:

- (1) Was Mr. Generes threatened by his employer with the loss of his job and salary if he did not sign indemnity agreements?
- (2) Was Mr. Generes, as an officer, director, and stockholder in the company, in such a position that it is unlikely he could have been fired for refusing to sign indemnity agreements?
- (3) Was the salary which he received from Kelly-Generes Construction Co. necessary for the support of himself and his family?
- (4) Was Mr. Generes faced with permanent unemployment if he lost his job with Kelly-Generes Construction Co.?
- (5) Was Mr. Generes told at the time he came to work for Kelly-Generes that signing such indemnity agreements was a condition to receiving his job with the company?
- (6) At the time the blanket indemnity agreement was signed, was Mr. Generes threatened by the company with the loss of his job if he failed to sign that agreement?
- (7) Was Mr. Generes in such a position as an officer, stockholder, and director of the company to control the amount of his own salary and to decide whether that salary should be stopped?
- (8) What was the amount of Mr. Generes' investment in the company which he would be protecting by signing the indemnity agreement?

(9) What was the amount of Mr. Generes' salary from the company which he would be protecting by signing the indemnity agreement?

(10) Did Maryland Casualty Company insist on Mr. Generes' signing the indemnity agreement by reason of the fact he was an employee of the company or because he was an owner and investor in the company?

While you should consider all of these factors as they bear on Mr. Generes' motivation for signing the agreement, you should not consider any factor, or a combination thereof, as controlling in reaching your decision.

Weddle v. Commissioner, supra.

Trent v. Commissioner, supra.

Fitzpatrick v. Commissioner, supra.

Given _____

Refused _____

SPECIAL VERDICT

(Number and Title Omitted)

We, the jury in the above matter, unanimously find as follows:

Interrogatory:

Do you find from a preponderance of the evidence that the signing of the blanket indemnity agreement by Mr. Generes was proximately related to his trade or business of being an employee of the Kelly-Generes Construction Company?

**Unanimous Answer
of the Jury**
YES
("Yes" or "No")

New Orleans, Louisiana, this 24 day of August, 1967.

**(Signed) WESLEY C. CLARK
Foreman of the Jury**

JUDGMENT

Filed: September 15, 1967

IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF LOUISIANA
NEW ORLEANS DIVISION

EDNA GENERES, WIFE OF AND
ALLEN H. GENERES, PLAINTIFFS

versus

Civil No. 16156
Section "C"

UNITED STATES OF AMERICA, DEFENDANT

This action came on for trial before the Court and a jury, Honorable Alvin B. Rubin, District Judge, presiding, and the issues having been duly tried and the jury having duly rendered its verdict,

It Is ORDERED, ADJUDGED AND DECREED by the Court that the plaintiffs recover from the defendant the sum of \$50, 134.49, plus interest according to law.

JUDGMENT entered September 18th, 1967.

(Signed) Alvin B. Rubin
ALVIN B. RUBIN, Judge.

Approved as to Form:

(Signed) MAX NATHAN, JR.

Attorney for Plaintiffs

(Signed) PETER WINSTEAD

Attorney for Defendant

**MOTION FOR JUDGMENT NOTWITHSTANDING
THE VERDICT AND ALTERNATIVELY
FOR NEW TRIAL**

(Number and Title Omitted)

Filed: October 6, 1967)

The defendant, United States of America, by and through its attorney, Louis C. LaCour, Esquire, United States Attorney for the Eastern District of Louisiana, hereby files, in accordance with Rule 50(b) of the Federal Rules of Civil Procedure, its motion for judgment notwithstanding the verdict and, alternatively for new trial, and as grounds for said motion would show the Court as follows:

1. This case was tried by the Court, sitting with a jury, on August 24, 1967. The jury returned a verdict for the plaintiffs on August 24, 1967. Judgment for the plaintiffs was entered by the Court on September 18, 1967.
2. The defendant made motions for a directed verdict at the close of the plaintiffs' case and at the close of all the evidence. The Court has denied those motions.
3. The Court erred in refusing to grant defendant's motions for directed verdict for the reasons set forth in the brief for the defendant and defendant's requested jury instructions, Nos. 1 through 17, and defendant's alternative requested jury instructions, Nos. 14, 14(a), and 14(b).
4. The evidence required a finding that the plaintiff, Allen H. Generes, was not required by his employer, Kelly-Generes Construction Co., to sign indemnity agreements as a condition to receiving employment and was not threatened by his employer with the loss of job and salary if he refused to sign indemnity agreements.
5. The evidence required a finding that the dominant motivation for Mr. Generes' signing the blanket indemnity agreement was to protect his investment in Kelly-Generes Construction Co.

6. The evidence required a finding that the only relationship between the signing of the blanket indemnity agreement and the protection of plaintiff's job and salary was an indirect or remote one, namely, that without the signing of the indemnity agreement, Maryland Casualty Co. would not have issued bonds, without such bonds Kelly-Generes Construction Co. would have been unable to obtain construction contracts, hence would have gone out of business, and all employees would have lost their jobs and salaries. This relationship was not proximate to any trade or business of the plaintiff, Allen H. Generes, as a matter of law.

7. The Court erred in refusing to instruct the jury in accordance with defendant's requested jury instruction No. 15, to the effect that the relationship described in paragraph 6 above, was not proximate to a trade or business of the plaintiff, as a matter of law.

8. The Court erred in refusing to instruct the jury in accordance with defendant's requested jury instruction No. 14, to the effect that the plaintiff's motivation in signing the indemnity agreement was irrelevant and immaterial in determining whether plaintiff was entitled to a business bad debt deduction. The Court erred in instructing the jury that the plaintiff's motivation was the determining factor.

9. Alternatively, the Court erred in instructing the jury that the plaintiff need only demonstrate that a significant motivation for signing the indemnity agreement was to protect his job and salary and in refusing to instruct the jury in accordance with defendant's alternative requested instructions, Nos. 14, 14(a), and 14(b), to the effect that the plaintiff must demonstrate that his dominant motivation for signing the indemnity agreement was to protect his job and salary.

10. The evidence required a finding that there was not a proximate relationship between the signing of the blanket indemnity agreement and the trade or business of Mr. Allen H. Generes, namely that of being a corporate employee rendering services for pay.

WHEREFORE, the defendant moves the Court to enter judgment notwithstanding the verdict in its favor, and alternatively, for a new trial.

LOUIS C. LACOUR
United States Attorney

(Signed) Peter Winstead

PETER WINSTEAD

Attorney, Tax Division

Department of Justice

7A06 Federal Building

Fort Worth, Texas 76102.

MINUTE ENTRY:

October 18, 1967

RUBIN, J.

EDNA GENERES, WIFE OF AND

ALLEN H. GENERES

Section "C"

versus

No. 16156

Civil Action

UNITED STATES OF AMERICA

This cause came on this day for hearing on motion of United States of America for judgment notwithstanding the verdict, and alternatively, for new trial.

PRESENT: EDWARD LOBMAN, Esq.
Attorney for Plaintiff

There being no objection;

IT IS ORDERED that motion of United States of America for judgment notwithstanding the verdict, and alternatively, for new trial, be, and the same is hereby, DENIED.

Kathleen Ruddell

AMENDED JUDGMENT

Filed: November 3, 1967

IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF LOUISIANA
NEW ORLEANS DIVISION

EDNA GENERES, WIFE OF AND
ALLEN H. GENERES, PLAINTIFFS

Civil No. 16156

Section "C"

UNITED STATES OF AMERICA, DEFENDANT.

This action came on for trial before the Court and a jury, Honorable Alvin B. Rubin, District Judge, presiding, and the issues having been duly tried and the jury having duly rendered its verdict.

IT IS ORDERED, ADJUDGED AND DECREED by the Court that the plaintiffs recover from the defendant the sum of \$49,943.19, plus interest according to law.

JUDGMENT ENTERED November 6th, 1967.

(Signed) Alvin B. Rubin

ALVIN B. RUBIN, JUDGE

Approved as to Form:

(Signed) **MAX NATHAN, JR.**

Attorney for Plaintiffs

(Signed) JOAN ELAINE CHAUVIN

Attorney for Defendant

NOTICE OF APPEAL

Filed: December 20, 1967

IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF LOUISIANA
NEW ORLEANS DIVISION

EDNA GENERES, WIFE OF AND
ALLEN H. GENERES, PLAINTIFFS

versus

Civil Action
No. 16156 "C"

UNITED STATES OF AMERICA, DEFENDANT

Notice is hereby given that the United States of America, defendant above named, hereby appeals to the United States Court of Appeals for the Fifth Circuit from the amended judgment in favor of plaintiffs entered in this action on November 7, 1967, and from the order denying the defendant's motion for judgment notwithstanding the verdict and, alternatively, for new trial entered on October 23, 1967.

Dated this 19th day of December, 1967.

LOUIS C. LACOUR
United States Attorney

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 25713

UNITED STATES OF AMERICA, APPELLANT

v.

EDNA GENERES, WIFE OF, AND
ALLEN H. GENERES, APPELLEES

*Appeal from the United States District Court for the
Eastern District of Louisiana.*

(May 25, 1970)

Before AINSWORTH and SIMPSON, Circuit Judges, and
SINGLETON, District Judge.

AINSWORTH, Circuit Judge: By this appeal the United States brings here for review a jury verdict and judgment below for the taxpayer¹ in an income tax refund suit. Taxpayer, in the early 1940's, entered into a partnership engaged in the construction business in New Orleans, Louisiana, with his son-in-law, William F. Kelly, who had already established the business. Taxpayer and Mr. Kelly were equal partners in this operation.

In 1954, the partnership was incorporated as Kelly-Generes Construction Company, Inc., which was engaged primarily in heavy construction work for various federal, state, city and public authorities. The corporation was essentially a closed family corporation with taxpayer and Mr. Kelly each owning 44 percent of the corporate stock. The remaining 12 percent of the stock was divided between another son-in-law of taxpayer, Mr. Louis Treuting, and taxpayer's son, Allen H. Generes, Jr.

Taxpayer was president of the corporation and in that capacity spent only approximately six to eight hours per week attending to the affairs of the corporation. His principal duties as president of Kelly-Generes Construction Company, Inc. were to obtain bank financing for corporate

¹ Throughout this opinion "taxpayer" will be used in the singular to refer to the husband, Allen H. Generes, since his wife is a party only because joint returns were filed for two of the taxable years here involved.

activities and to secure performance and bid bonds on construction jobs undertaken by the company. In his individual capacity, taxpayer endorsed loans made to the corporation by various banks in New Orleans for the purpose of purchasing construction machinery and other equipment. In addition, taxpayer from time to time personally advanced funds to the corporation. Taxpayer, as president of the corporation, received a salary of \$12,000 per year and Mr. Kelly, as vice-president and the one in charge of the day-to-day operations of the corporation, received a salary of \$15,000 per year.

During all the years in question, taxpayer was the president of Central Savings and Loan Association in New Orleans of which he was the founder. This was a full-time job for which he received a salary in the amount of \$19,000 per year. In addition, taxpayer had other sources of income; his federal tax returns for the years 1959 through 1962 indicate an average income of approximately \$40,000 a year. Taxpayer, during the years in question, maintained bank accounts ranging in total amount from \$30,000 to \$55,000.

The construction contracts undertaken by the corporation generally required performance and payment bonds, the greatest number of which were obtained from the Maryland Casualty Company. Taxpayer was required to sign separate indemnity agreements with Maryland Casualty Company for each bond issued by that company for a job being performed by Kelly-Generes Construction Company, Inc. These indemnity agreements provided that taxpayer agreed to hold Maryland Casualty Company harmless from any losses suffered by reason of any defaults by the corporation which would require the surety company to perform or pay under its bonds.

Subsequently, in December of 1958, it was decided that it would be advisable for taxpayer to execute a blanket indemnity agreement in lieu of signing a separate indemnity agreement for each construction job. Thus, on December 3, 1958, an instrument entitled "Blanket Indemnity Agreement" with Maryland Casualty Company was signed by the corporation as applicant, through taxpayer its president, and in addition was signed individually by taxpayer and William Kelly as indemnitors. Under this agreement,

taxpayer agreed to hold harmless the Maryland Casualty Company from any loss sustained as a result of its bonding the construction jobs of Kelly-Generes. At the same time, Maryland Casualty Company agreed to increase the surety credit of Kelly-Generes from approximately \$1,000,000 to \$1,500,000 for any one job and to a total credit line of \$2,000,000 inclusive of all jobs bonded by them.

In 1962, Kelly-Generes underbid on two important projects and defaulted in the performance of its contracts. As a result, Maryland Casualty Company was forced to complete performance. Subsequently, Maryland Casualty Company sought enforcement of the indemnity agreement of December 3, 1958 against taxpayer, and Mr. Kelly, and as a result the taxpayer, in 1962, was forced to pay \$162,104.57 to Maryland Casualty Company. Kelly-Generes eventually went into receivership and taxpayer was unable to collect the above amount from the company as a subrogated creditor.

On the federal income tax return for 1962, taxpayer deducted the amount of the payment to Maryland Casualty Company as a business bad debt and subsequently filed claims for refund for the years 1959, 1960 and 1961 by virtue of a net operating loss carryback to those years arising from the unused portion of the 1962 business bad debt deduction. The Internal Revenue Service paid the claim upon the filing by taxpayer of the tentative carryback claim. However, the Internal Revenue Service later disallowed the net operating loss carryback on the ground that the payment by taxpayer to Maryland Casualty Company did not give rise to a business bad debt deduction.² Accordingly, assessments in the aggregate amount of \$43,851.46 plus statutory interest were made against taxpayer on May 28, 1965. Payment of these assessments was received by the Internal Revenue Service on June 2, 1965, and, on June 8, 1965, taxpayer filed claims for refund of the amount

² If the bad debt in question could be classified as a business bad debt under 26 U.S.C. § 166(a)(1), the net operating loss carryback would be proper under the provisions of 26 U.S.C. § 172. If, however, the bad debt was of a nonbusiness nature as defined by 26 U.S.C. § 166(d), the taxpayer could not avail himself of the net operating loss carryback. 26 U.S.C. § 172(d)(4).

previously paid. These were denied by the Commissioner and the suit below was timely filed thereafter.

Trial was before a jury. Both parties unsuccessfully moved for directed verdicts at the close of all the evidence. Upon submission by special issues the jury returned a verdict under which the taxpayer was entitled to recover the amount in suit. The Government then moved for judgment n.o.v. and alternatively for a new trial. These motions were denied, judgment was entered in accordance with the verdict and this appeal followed. We affirm.

The facts recited above are as set forth in the Government's brief and are not disputed by taxpayer. The sole question presented is whether the taxpayer's loss gave rise to business bad debts within the meaning of 26 U.S.C. § 166.³ In order to answer that question, it is necessary to determine whether the taxpayer's endorsement was motivated out of a desire to protect his trade or business, i.e., that of being president of the Kelly-Generes Construction Company. See *Kelly v. Patterson*, 5 Cir., 1964, 331 F. 2d 753; *Trent v. C.I.R.*, 2 Cir., 1961, 291 F. 2d 669.

Treas. Reg. § 1.166-5(b), 26 C.F.R. § 1.166-5(b), provides that the debt is deductible as a business bad debt only if "the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer" is "*proximate*." (Emphasis added.)

³ The pertinent provisions of the statute are:

"§ 166. Bad debts

"(a) General rule.—

"(1) Wholly worthless debts.—There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

"(d) Nonbusiness debts.—

"(1) General rules.—In the case of a taxpayer other than a corporation—

"(A) subsections (a) *** shall not apply to any nonbusiness debt; and

"(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months.

"(2) Nonbusiness debt defined.—For purposes of paragraph (1), the term 'nonbusiness debt' means a debt other than—

"(A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or

"(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business."

The Supreme Court indicated its approval of the "proximate relationship" test in *Whipple v. C.I.R.*, 373 U.S. 193, 83 S. Ct. 1168 (1963). In vacating and remanding *Whipple* to the Tax Court for a determination of whether a taxpayer's loan was made in his business of being a landlord, the Court noted:

Moreover, there is no proof (which might be difficult to furnish where the taxpayer is the sole or dominant stockholder) that the loan was necessary to keep his job or was otherwise proximately related to maintaining his trade or business as an employee.

373 U.S. at 204, 83 S. Ct. at 1175. (Emphasis added.)

The District Court's sole interrogatory to the jury, answered in the affirmative, was phrased in terms of proximate relationship. The jury was asked:

Do you find from a preponderance of the evidence that the signing of the blanket indemnity agreement by Mr. Generes was proximately related to his trade or business of being an employee of the Kelly-Generes Construction Company?

The Court instructed the jury that

A debt is proximately related to the taxpayer's trade or business when its creation was significantly motivated by the taxpayer's trade or business, and it is not rendered a nonbusiness debt merely because there was a non-qualifying motivation as well, even though the non-qualifying motivation was the primary one.

The Government urges that "dominant motivation" and not "significant motivation" was the appropriate test for determining the proximate relationship of the debt to the taxpayer's business and that the District Judge's charge to the jury was therefore erroneous. Neither the Supreme Court nor this Court has ruled on the precise question. However, the above-quoted language of the Supreme Court in *Whipple, supra*, which impliedly requires proof only that a loan be "proximately related" to the maintenance of a taxpayer's trade in order that a deduction be allowed, precludes the imposition of dominant motivation proof on the taxpayer. We are impressed with the majority holding in the Second Circuit decision in *Weddle v. C.I.R.*, 1963,

325 F. 2d 849, and its analogy between proximate cause and significant motivation.⁴

The Court in *Weddle* in disavowing the "primary" motivation test as an erroneous view of law, said:

That is not what is said either by the statute or by the Regulations, which the Supreme Court inferentially approved in *Whipple v. C.I.R.*, 373 U.S. 193, 204, 83 S. Ct. 1168, 10 L. Ed. 2d 288 (1963). In the law of torts, where the notion of "proximate" causation is most frequently encountered, a cause contributing to a harm may be found "proximate" despite the fact that it might have been "secondary" to another contributing cause. See 2 Harper & James, *The Law of Torts*, §§ 20.2 and 20.3; American Law Institute, *Restatement, Torts*, §§ 432(2), 433, 439, 875, 879 (1939); *Restatement Second, Torts* § 443A at 54 (Tent. Draft No. 7, 1962), § 442B at 29 (Tent. Draft No. 9, 1963). So here, particularly in view of the backhanded wording of § 166, it suffices for deduction that the creation of the debt should have been significantly motivated by the taxpayer's trade or business, even though there was a non-qualifying motivation as well.

325 F. 2d at 851.

We find no error in the District Court's instruction relative to the significant motivation of taxpayer in determining the proximate relation of a debt to his trade or business.

Therefore, if the evidence was such that the jury could have reasonably concluded that the taxpayer's endorsement was motivated by a desire to preserve his business of being a corporate employee the jury could have properly determined that the bad debt was proximately connected with the taxpayer's trade or business. Taxpayer repeatedly testified that he signed the agreement in order to protect his job and his salary as an officer of Kelly-Generes.⁵ While

⁴ The Government relies on a concurring opinion in *Weddle* which rejects the majority's "significant motivation" test and suggests as the proper criteria a "primary and dominant motivation."

⁵ The following cross-examination of Mr. Generes is pertinent:

"Q. Let me ask you what motivated you to endorse or sign those notes on behalf of the corporation?

"A. The corporation was paying me \$12,000 a year. I had \$38,000 in it, and I figured in three years' time I would get my money out. (App. 107)

"Q. I believe you also stated you were interested in your salary because, if

admittedly much of the testimony was self-serving, the credibility and sincerity of taxpayer, the assessment of which is undisputedly a jury function, were decided in his favor.* Moreover, there was uncontradicted testimony of witnesses other than taxpayer from which the jury could have inferred that taxpayer's motivation in endorsing the agreement stemmed from his desire to protect his job and consequently his salary. The record shows that no performance bonds would have been issued to Kelly-Generes without the personal endorsement of Mr. Generes. Without the bonds the corporation would have gone out of business. The corporation was a closed corporation, privately held and no stock was available to the general public. At no time did the corporation pay dividends to its shareholders.

you did not sign the indemnity agreement, the Maryland Casualty Company wouldn't execute the bonds and Kelly-Generes Construction Company couldn't get contracts and, therefore, would go out of business, and you would lose your job; is that right?

"A. That is perfectly correct. (App. 118)

"Q. Is that the relationship between your signing of the indemnity agreement and your job?

"A. The reason I signed that indemnity agreement was to protect my job.

"Q. Through protecting your investment, through protecting Kelly-Generes Construction Company?

"A. The investment was very small, only \$38,000, and I figured that if I signed this bond—I get \$12,000 a year; in three years' time I would be practically paid out of my investment. ***

"Q. At the time you signed it, did you give consideration to the fact that you were protecting your job and salary at the time you signed it?

"A. That's the reason I signed it. (App. 119)

"Q. To protect your job and salary?

"A. That's the reason I signed it.

"Q. Did you give any thought at all to your investment in the corporation?

"A. No, I never once gave it a thought. *** I never thought about dividends because we were growing, and I signed the indemnity bond for the purpose of protecting my salary, and that is what I had in mind. (App. 120)
*** To tell you the truth about it *** I never gave that a thought. I never gave my investment a thought. That \$1,000 a month I was getting and trying, as I said, to build up an estate for my children." (App. 122)

* In *United States v. Worrell*, 5 Cir., 1968, 398 F. 2d 427, this Court reversed and remanded a decision in favor of taxpayer under circumstances somewhat similar to those here. At issue in *Worrell*, as here, was taxpayer's motivation in signing as an indemnitor of the corporation's surety creditor. However, one essential difference between *Worrell* and the present case exists. *Worrell* was tried to the Court entirely on stipulations and documentary evidence; there was no oral testimony and "no word from Mr. Worrell or anyone else as to what his motive was in signing these indemnity contracts." 398 F. 2d at 428.

The ultimate question, therefore, is whether the evidence formed a sufficient basis to justify the Trial Judge's submission of the case to the jury. The applicable standard is that expressed in our recent en banc decision, *Boeing Company v. Shipman*, 5 Cir., 1969, 411 F. 2d 365, 374-375:

On motions for directed verdict and for judgment notwithstanding the verdict the Court should consider all of the evidence—not just that evidence which supports the hon-mover's case—but in the light and with all reasonable inferences most favorable to the party opposed to the motion. If the facts and inferences point so strongly and overwhelmingly in favor of one party that the Court believes that reasonable men could not arrive at a contrary verdict, granting of the motions is proper. On the other hand, if there is substantial evidence opposed to the motions, that is, evidence of such quality and weight that reasonable and fair-minded men in the exercise of impartial judgment might reach different conclusions, the motions should be denied, and the case submitted to the jury. A mere scintilla of evidence is insufficient to present a question for the jury. The motions for directed verdict and judgment n.o.v. should not be decided by which side has the better of the case, nor should they be granted only when there is a complete absence of probative facts to support a jury verdict. There must be a conflict in substantial evidence to create a jury question. However, it is the function of the jury as the traditional finder of the facts, and not the Court, to weigh conflicting evidence and inferences, and determine the credibility of witnesses. (Footnote omitted.)

Under the standards of *Boeing* we hold that the District Court properly denied the motions of the Government for judgment n.o.v. and for a new trial.

Affirmed.

SIMPSON, *Circuit Judge*, Dissenting: I respectfully dissent.

I believe that the only test that will inject sufficient certainty into the interpretation of Title 26, U.S.C. Section 166, is the *dominant and primary motivation test* articulated by Chief Judge Lombard in his concurring opinion in *Weddle v. Commissioner of Internal Revenue*, 2 Cir., 1963, 325 F. 2d

849, 851. The Seventh Circuit recently adopted this standard in *Niblock v. Commissioner of Internal Revenue*, 7 Cir., 1969, 417 F. 2d 1185.

The bare self-serving statements of Taxpayer were the sole evidence offered by him as to his motivation. If the dominant motivation criterion had been applied, I do not think these statements would have been sufficient under *Boeing Company v. Shipman* standards of proof¹ to take the case to the jury in the face of the clear proof that Generes and Kelly were required to sign the endorsement in order for the corporation to engage in the construction business. This problem of proof was prophetically forecast by *Whipple v. Commissioner*, 373 U.S. 193, 204, 83 S. Ct. 1168, 10 L. Ed. 2d 288, 295:

Moreover, there is no proof (which might be difficult to furnish where the taxpayer is the sole or dominant stockholder) that the loan was necessary to keep his job or was otherwise proximately related to maintaining his trade or business as an employee. (Emphasis supplied.)

On this basis, I would reverse the judgment below and remand with directions to the trial court to enter judgment N.O.V. in favor of the United States.

¹ *The Boeing Company v. Shipman*, 5 Cir. 1969, 411 F. 2d 365, 374, 375.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1967

No. 25713

D.C. Docket No. CA 16156-C

UNITED STATES OF AMERICA, APPELLANT

v.

EDNA GENERES, WIFE OF, AND ALLEN H. GENERES,

APPELLEES

*Appeal from the United States District Court for the
Eastern District of Louisiana*

Before AINSWORTH and SIMPSON, Circuit Judges, and
SINGLETON, District Judge.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Eastern District of Louisiana, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

It is further ordered, That appellant pay to appellees, the costs to be taxed by the Clerk of this Court.

SIMPSON, Circuit Judge, Dissenting:

"Per AINSWORTH, C. J."

May 25, 1970.

SUPREME COURT OF THE UNITED STATES

No. 883. - - - - , October Term, 1970

UNITED STATES, PETITIONER,

v.

EDNA GENERES, WIFE OF, AND ALLEN H. GENERES

ORDER ALLOWING CERTIORARI. Filed March 22, 1971.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted.